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**INDIA'S ECONOMIC DEVELOPMENT AND
INTERNATIONAL ECONOMIC RELATIONS**

INDIA'S ECONOMIC DEVELOPMENT AND INTERNATIONAL ECONOMIC RELATIONS

by
MOHD. SHABBIR KHAN



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P R E F A C E

THIS WORK was done during my tenure of guest professorship at the University of Chicago in the spring and summer quarters of 1959. I am thankful to the University of Chicago for its kindness in appointing me as Visiting Professor of Economics and to the Relm Foundation which financed the assignment. However, the ideas expressed in this book are entirely mine, and neither the University of Chicago nor the Relm Foundation is responsible for them.

My wife Kishwar (who is an economist in her own right) was associated with me in all stages of the development of this work. Without her active cooperation the publication of the work would have been considerably delayed.

Aligarh
January, 1961

MOHD SHABIR KHAN

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INTRODUCTION

IN THIS BOOK we set out to consider the problem of long-run development of Indian economy and see what role can international economic relations play in it. It is, therefore, imperative to consider first the phenomenon of the process of growth in the institutional and the economic set up of India. The role of international relations can be discussed only if we know how the economy really develops and what are the prime movers of economic development in a society like India. Various economic models have been constructed to describe the process of economic growth. The art of model building lies in selecting some of the more important variables of the economic system, which act and react upon each other, and find out the functional relationship between them. This means that the variations in these carefully chosen variables, indeed, would lead to the behaviour of the system in a desired way. The usefulness of a model lies in its depicting the framework of reality with the help of a few variables. We shall, therefore, examine as to which one of the growth models or a combination of them describes the functioning of Indian economy and can give an insight into the process of growth. This will be done in the first chapter.

These growth models have been propounded, in the first instance, to describe a closed economic system. Since our objective is to consider the impact of international economic relations on the Indian economic development, we shall also have to consider the question of economic development in its wider perspective to find out the effect of international relations. These relations can be broadly conceived in two ways, namely, by considering the question of foreign trade not only in the static setting but also from the point of view of the dynamics of growth and expansion or otherwise of foreign trade of India, and the role of the flow of international capital both as direct grants and loans from private or inter-governmental agencies. We would be required to consider the question of international trade versus autarchy and the question of international flow of capital. These would form the subject matter of the second and third chapters, respectively.

All this would give us a theoretical framework and provide a clue to the understanding of the real problem. This theoretical discussion will have to be substantiated by what has actually happened in India. We would concentrate our attention on the period of economic planning. Analytically, this is not a very sound proposition because this period is too short to give us the clear perspective of the relationship between economic theory and its application, yet we have our choice of this because the real efforts at national economic development started only after Independence. And it is in this setting that we really want to understand the role of international relations in matters of economic development. We would, therefore, try to give a brief sketch of what has happened during the planning period in the domain of international economic relations, how it has influenced the pattern of growth and what prospects does it hold for the future.

CHAPTER I

PROCESS OF ECONOMIC GROWTH

WE PROPOSE to examine in this chapter some of the models of economic growth in relation to the functioning of the Indian economic system. It must be pointed out in the very beginning that a model does not describe the reality in all its complexities, but is only a snapshot of the reality. Thus its usefulness lies in understanding the broad perspective rather than the actual complexities. It does not mean however that all models which have been constructed are useful or they are useful under all circumstances. Some of these fail even the test of broad applicability sometimes and then they are no good as models, often very many of them are true only under certain circumstances and are incapable of exhibiting the real phenomenon in different economic and social set ups. We propose to consider broadly three types of models: models of the Keynesian system, those related to the Marxian system and those which are related to the much too neglected Schumpeterian system.

GROWTH MODELS RELATED TO KEYNESIAN ECONOMICS

The most important models of this type are the Harrod-Domar models of growth, or their varieties. The simple postulate on which these are based is that the rate of investment leads to not only the creation of income but also the creation of capacity and when capacity of a certain magnitude has been created national income should increase to such an extent as to fully absorb it. In these models the rate of the increase of income has been considered to be proportionate to the rate of increase of investment. In simple mathematical terms if α is the rate of net investment (that fraction of net national income which has been saved) and β , the ratio of the increase of net national income to the net investment associated with it per unit of time then the rate of the increase of income would be $\alpha\beta$. If the rate of increase of income is indicated by ∂ , the equation indicating the growth of income would be $\partial = \alpha\beta$.

Simple as this model is, it sometimes leads to misunderstanding unless some broad implications are clearly understood. First, the coefficient β (which is the inverse of the marginal capital coefficient) has been considered both in its behaviouristic and technological aspects. The behaviouristic relation indicates the behaviour of the entrepreneurial class in that the increase in investment is *via* accelerator related to the increase in the level of income, and the technological aspect indicates the input-output relation under a given technological condition. Secondly, the principal role in the models is played by capital and labour stays behind. This has been done with the plea that in the case of the developed countries capital is the most important factor of production, and in the case of the underdeveloped countries it is the lack of capital which is the greatest bottleneck to the process of economic development. Domar has in fact gone to such an extent as to suggest that the coefficient β should be considered not as a function of capital but as *associated with capital*, which would mean that the input of labour has already been taken into account when the effect of the input of capital is taken into consideration. This leads to the third implication of the model which assumes the production function of a certain type. It takes for granted that when increased investment leads to the growth of capacity either the labour power increases or the labour becomes more efficient or the technique of production changes or any variant of the three takes place so that the increased capacity is made possible.

Some variants of the model try to take account of the increase in labour force by deducting the rate of the increase of population from the total rate of growth to find out the possible net increase in the level of income. If r indicates the rate of growth of population, then the rate of increase of income would be indicated by the following equation

$$\partial - \alpha\beta - r$$

It may be seen that even this simple equation throws considerable light on the process of economic growth of an underdeveloped economy. For instance it shows that given the rate of net investment the capital coefficient and the rate of increase of population, the rate of development of the economy can be

determined. It also shows that given the rate of development of the economy, the rate of net investment and the capital coefficient, how much increase of population can be absorbed into the economic system. It can further show that, given the desired rate of development, rate of net investment and the rate of growth of population, what kind of technology will have to be adopted to give the consistent capital coefficient required. And finally it can show that given the rate of increase of population, capital coefficient and the desired rate of economic growth, how much net investment will have to be pushed to make it consistent with the process of growth.

It may be noted that this equation was used in the First Five Year Plan to determine the possible rate of growth in India. The rate of investment, the capital-output ratio and the rate of growth of population were considered to be the main determinants in finding out the possible rate of growth. For instance the Planning Commission says

In estimating possible rates of development in India, what they would involve in terms of effort required and what they would achieve, there are two or three major factors to be taken into account. The proportion of the addition to the national income in each period which is decided to plough back is [thus] one of the major determinants of the rate of development. But this proportion cannot itself be fixed in given situation without reference to two other factors. These are (a) the rate of growth of population, and (b) the increase in national output, and income likely to follow a given increase in the capital stock.¹

It estimated that the rate of growth of population would continue to be at the rate of about $1\frac{1}{2}$ per cent per annum and that the capital-output ratio would be 3:1. With these assumptions it tried to find out the possible rates of growth of the economy and the necessary rates of investment needed for such rates of growth. It started with a national income approximately of Rs. 9,000 crores in 1950-51. It then argued that if the country wanted the national income to be raised by over 160 per cent in

¹ Government of India, Planning Commission, *The First Five Year Plan*, p. 18.

about twenty-two years and the per capita income doubled, capital formation would have to be stepped up from the very beginning to as much as two-thirds of the additional income each year. On the other hand, if capital formation was raised more gradually, say by 25 per cent of the additional income in each period, the rate of the growth would be rather slow, in twenty-two years it will increase only by 80 per cent and the per capita income even less. It was, therefore, decided that the capital formation should be somewhat less than two-thirds but more than a quarter of the additional income to achieve a sizable increase in income. It estimated a rise of about 20 per cent of the additional income in the capital formation during the First Five Year Plan, and an amount equal to 50 per cent of the additional output from the year 1956-57 onwards. This would raise the rate of savings in proportion to the total national income from 5 per cent in 1950-51 to 6½ per cent in 1955-56, to about 11 per cent in 1960-61 and to 20 per cent by 1967-68. Thereafter it would continue to be 20 per cent of the total national income. On such calculations it estimated that the per capita income would be doubled in about twenty-two years.¹

Although the Planning Commission was careful to point out that the figures were "intended to indicate only broadly the implications in terms of effort and return in terms of alternative courses of action", yet a great reliance on the part of the Commission can be discerned on the variables mentioned above in the growth model. Certain implications of this faith were, I think, not fully realized. For instance it was not realized that the constant capital coefficient of 3.1 was a very bold assumption specially in view of the fact that agriculture was given top priority in the First Five Year Plan. The input-output relation, which can be fairly approximately determined in other sectors with some certainty, is very difficult to be determined in agriculture because there at least one input that is climate, is very uncertain. A favourable monsoon in India can change the capital-output ratio in favour of the economy and vice-versa. It has been very aptly remarked that the input output relation is like a cook-book in which definite magnitudes of various inputs combined together are likely to give a definite result. In agriculture, although the cook-book is there the oven on

¹ Cf. *Ibid.*, pp. 20-31.

which the food is cooked is very uncertain, and it might lead to enormous variation in results. Facts show that the mistake was not realized even after the First Five Year Plan was evaluated. The fact that the total expenditure was less than that projected for and the targets achieved more than anticipated was actually not a matter for congratulation. It should have been realized that the calculations were wrong somewhere and the greatest probability was in the unreliability of monsoons.

The Second Five Year Plan was started with great satisfaction that the First Five Year Plan was a success and that a bigger and bolder programme of economic development specially in building up the base for industrial development could be started. This turned out to be a fallacy as was later on seen in the food shortage since the beginning of the Second Five Year Plan which is one of the most important reasons for the balance of payments difficulty.

In fact, the concept of capital-output ratio as applied to the whole economy is a misnomer. There are different compositions of capital, in the micro-economic sense, in various sectors and sub-sectors. Then there is the great difficulty in this concept especially in regard to a country like India where a great proportion of the economy is a subsistence economy or has only recently entered into very simple exchange economy. Finally, there is the difficulty in relation to the dynamic conditions. The process of growth is inevitably associated with the change of technology and as such the capital-output ratio through time is bound to change.

Another difficulty about this model of growth lies in its bold assumption that the full capacity use of capital will automatically lead to the full employment of labour. It is by no means necessary that the first should lead to the second. Hamberg has suggested³ that it is useful to write α as the coefficient of the required rate of growth which is defined as the ratio between the full employment growth rate and the full capacity growth rate. It can be written as $\alpha = \frac{E}{U}$ where E stands for full employment growth rate and U for the full capacity growth rate. When α is 1 the two rates of growth will be equal to each other. This

³ See D. Hamberg, 'Full Capacity vs. Full Employment Growth', *The Quarterly Journal of Economics* 1952, pp. 441-9.

would be the ideal growth pattern. But when α is greater than 1 the full employment rate of growth will be greater than the full capacity rate of growth. In this case the full capacity rate of growth will not be sufficient to utilize fully the increased labour supply and consequently a secular increase in the labour supply will take place. There would be something like the Marxian army of the unemployed labour and this would grow at an increasing rate even when the growing capital is fully utilized. But even this re-formulation of the Harrod-Domar growth model is incapable of giving full insight into the problems of an economy like India. The great amount of underemployment which exists in our economy can be taken care of through this re-formulation. But the greater amount of unemployment which results through disintegration of the subsistence economy, with the process of growth, and which increases even without an increase of population, cannot be fully explained and taken care of in this model.⁴

Nevertheless the model as it is can provide some useful ideas about the process of economic development. For instance, it emphasizes the importance of the accumulation of capital in the process of economic growth. It also suggests that a rapid increase in population is a great hindrance to our economy in the process of economic growth, because the higher the rate of growth of population the greater will have to be the deduction from the gross rate of growth of income to find out the net position. Even these ideas have got to be carefully scrutinized. The accumulation of capital in an economy like India should be used in a wider sense of the term to mean not only the material capital but also the human capital. But human capital cannot be easily accumulated without a lot of investment in human beings which presupposes a certain degree of development. Thus therefore blurs the distinction between capital as an independent variable and development as a dependent variable. Both of them might act and react upon each other. As Bauer has suggested it is more appropriate to say that capital is accumulated through the process

⁴ Raj has shown that this type of unemployment is the most important one from the point of view of an economy like India. Cf. K. N. Raj, *Employment Aspects of Planning in Underdeveloped Economies* (National Bank of Egypt Fiftieth Anniversary Commemoration Lectures (Cairo 1957) pp. 6-9.

of growth rather than to say that economic development is a function of accumulation of capital⁵

MAHALANOBIS MODEL

An important variety of the Harrod-Domar model is the Mahalanobis model which takes into account the division of economy into two sectors the one called K , producing investment goods and the other, C , producing consumption goods. The total net investment has been divided into λ_k to increase the production of K sector and λ_c for the production in C sector. λ_k and λ_c are the fractions of the total investment so that $\lambda_k + \lambda_c = 1$.

Mahalanobis uses α as the rate of investment and β the ratio of increment of income generated to the total net investment of the economy. In the two-sector model, β can also be considered in relation to sector K and C , β_k indicating the ratio of the increment of income to investment in the K sector, and β_c indicating the ratio of increment of income to investment in C sector. The overall β would then be equal to $\lambda_k\beta_k + \lambda_c\beta_c$.

It can be seen that the ratio of total income to the income generated in sector K can be written as

$$\beta = \lambda_k\beta_k \text{ or } \frac{\lambda_k\beta_k + \lambda_c\beta_c}{\lambda_k\beta_k}$$

If the output of sector K at the end of period zero is unity, then in period 1 it would be $K=1+\lambda_k\beta_k$. In period t the output would be $(1+\lambda_k\beta_k)^t$ and the increase in output in sector K would be $(1+\lambda_k\beta_k)^t - 1$.

If K_0 is the initial investment the increase in output would be $K_0\{(1+\lambda_k\beta_k)^t - 1\}$.

Mahalanobis has defined the rate of investment as the ratio between the value of output of the investment goods and the national income. It would mean that the value of output of the investment sector will be equal to the rate of investment multiplied by the level of income and hence

$$K_0\{(1+\lambda_k\beta_k)^t - 1\} \text{ can be written as } Y_0\alpha_k\{(1+\lambda_k\beta_k)^t - 1\}$$

This gives us the magnitude of increase in sector K . If we mul-

⁵ P T Bauer, *Economic Analysis and Policy in Underdeveloped Countries* (Durham, N C and London, 1957) p 119

multiply this by $\frac{\lambda_k \beta_k + \lambda_c \beta_c}{\lambda_k \rho_k}$ or ratio of total income to the income generated in sector K then we would get an increase in total output which would be

$$Y_0 \propto \frac{\lambda_k \rho_k + \lambda_c \beta_c}{\lambda_k \beta_k} \{ (1 + \lambda_k \rho_k)^t - 1 \}$$

Income in year t would be

$$Y_t = Y_0 [1 + a_0 \frac{\lambda_k \rho_k + \lambda_c \beta_c}{\lambda_k \beta_k} \{ (1 + \lambda_k \rho_k)^t - 1 \}]$$

In this equation expression $\frac{\lambda_k \rho_k + \lambda_c \beta_c}{\lambda_k \beta_k}$ indicates that higher the value of λ_k the smaller would be the ratio of total income to the income generated in sector K . But this higher increase in λ_k would lead to a greater total output of K and since the output of K in a period t would be $(1 + \lambda_k \rho_k)^t$ the very high λ_k indicates that level of income would after a certain time increase at an accelerated rate.

Thus the basic result of such a formulation is that in the long run the rate of development of the economy would be the function of the increasing rate of investment and that the higher the rate of investment the lower would be the income generated in the short run but the greater would be the speed at which the income will increase after a critical period. This equation in a way reformulates the famous remarks of Boehm-Bawerk that the roundabout methods of production have both an advantage and a disadvantage. Their advantage lies in the fact that they are more productive but they are disadvantageous in that they are lengthy and the greater productivity is achieved only after a lapse of time. The implication however of this statement is obvious in that the greater the roundaboutness of the method of production the greater must be the provisions already at hand out of which the factors of production are remunerated not only in the monetary sense but in the real sense as well. To make it more explicit there must be enough supply of food and other consumer's goods available by which the factors of production can be sustained.

Mahalanobis seems to have realized at least partly this implication when he suggests that in India the correct policy is to increase both consumption and investment.⁶ He says the

⁶ Cf. *Sankhya (The Indian Journal of Statistics)* Vol. 16 parts 1 and 2 pp. 15-16.

increasing investment in sector A would generate new purchasing power and hence new demand for consumption goods would be created. This new demand, according to him, can be satisfied by investing whatever is left of total national capital into the small-scale industries which will produce goods to match the increased demand through investment in heavy industries. But this presupposes a very elastic supply of agricultural produce to which Mahalanobis does not pay attention presumably because he also thinks that the First Five Year Plan has already fulfilled that condition. But these assumptions turned out to be false.

Other implications of this model of growth may also be noted specially because Mahalanobis is very particular to point out that the operational model which he has formulated is designed specially to meet the requirements of India and that it would be only by chance that it may be of some use to other countries.⁷ A model of this sort must be based on assumptions which are at least approximately correct in the case of our country.

The first assumption which seems to be essential for this model is that the supply of labour is infinitely elastic and as such cannot create a bottleneck so far as the productive structure is concerned. Apparently, it is a fairly reasonable assumption under Indian conditions where the problem of under employment and unemployment is so acute. But, paradoxical though it may seem, in fact, the assumption of infinitely elastic labour supply in India is not at all correct. The paradox disappears if we recall that the labour supply which is needed for the productive structure of a country is not just the surplus human power, but skilled well-trained disciplined and well settled elite of labour and managerial skill. No one can doubt that a lot of capital has to be invested in the human beings before such a supply of labour may be forthcoming. Zakir Husain in his lectures on Capitalism,⁸ pointed out this apparent contradiction between a lot of surplus human power and the scarcity of industrial labour power which was realized at the time of the Industrial Revolution in many of the Western countries, and that this contradiction could be resolved by looking into the educational and social backgrounds which were needed for the industrial development of a country.

⁷ Ibid. p. 6

⁸ Zakir Husain, *Capitalism: An Essay in Understanding* (Delhi, 1948)

The second basic assumption which is needed for the fulfilment of the model is that the period of gestation is the same in all the sectors. Now this assumption can hardly be true in India or for that matter in any other country of the world. But this might be considered a simplifying assumption insofar as the various periods of gestations can be taken account of by different weights to various sectors. The greater the speed of production and circulation of capital in a certain sector, the greater would be the effectiveness of capital and the greater would be the capital, from the practical point of view, available for rotation. [An inquisitive reader can be referred to the interesting chapter in Marx's *Capital* (Volume III) on the "Different Periods of Rotations of Different Capitals"] Viewed in this way it is realized how useful can it be for a country like India to find out those areas of employment of capital where capital can circulate at a greater speed so that it may become more effective and give quick results. One wonders whether possibilities cannot be explored where old machines taken on half or less than half the price of the original can be used with great advantage because they lead to the rotation of capital at a greater speed.

The next assumption also a simplifying one, is that the technique of production between the periods zero and t does not change. This is a very heroic assumption if we consider the long term period of growth for which the model has been designed. In fact it is very difficult to introduce into a simplified model the change in technology. Domar found this task very difficult, Harrod evaded the difficulty by assuming a neutral technological change and thus the real problem of a developing economy was left behind. We shall have occasion to see how Schumpeter based his model of the growth of a capitalist economy on technological change. Marx found a great compulsion for the capitalists to go on ruthlessly changing the method of production. In a country like India which is on the way to progress a model of growth without technological development cannot claim to take us very far. This is borne out by the fact that since the Planning Commission of India did not consider the capital-output ratio of any fixed magnitude in the long term calculations it has been changing the value of the coefficient though again it has made a mistake in considering an overall capital-coefficient of the economy.

One very specific assumption which Mahalanobis has made is that λ has been divided into λ_t and λ arbitrarily from the point of view of some desired rate of growth and that it is kept constant in between the periods zero and t . It is based on the reason that the long term rate of growth depends on the greater investment in the producers' goods industries rather than in consumers' goods industries. Mahalanobis here misses the essential point that the long term rate of growth depends on greater and greater production of investment goods and not on greater investment as such. And this greater production of investment goods can forthcome from the greater and greater surplus that is to say, production over consumption of goods which can be made available from the consumers' goods sector.

We discussed Mahalanobis's model and its implications in great detail because that happens to be the operational model on which the Second Five Year Plan has actually been based. The first three objectives for instance of the Second Five Year Plan are laid down as

- (a) a sizable increase in national income so as to raise the level of living in the country,
- (b) rapid industrialization with particular emphasis on the development of basic and heavy industries and
- (c) a large expansion in employment opportunities.²

It was realized that any significant increase in the national income cannot take place without increasing the investment goods, and if the industrialization were to be rapid the country must aim at developing basic industries which make machines to make the machines needed for further development. Now this is the emphasis on the greater and greater roundaboutness of production which would indeed increase production in the long run but would also entail a sacrifice in the sense that less and less consumers' goods would be available in the short run. Partly this deficiency of consumers' goods was to be made good through directing more and more labour to the cottage industries which was simultaneously expected to create the employment opportunities and produce consumers' goods—thus killing, so to say, two birds with one stone, namely, on the one hand

² *Second Five Year Plan* p. 24

solve the problem of unemployment and on the other produce consumers' goods which could match the increased demand by those employed in heavy industries

This, however, presupposes two basic developments to have taken place. Firstly, that there was enough of increased food production for all to consume, and secondly that enough human capital was available in the sense that there was no scarcity of skilled labour and management and that the exchange economy was all-pervading in the country. None of these basic requirements were fulfilled. The first has already proved to be a bottleneck, the second would, I think, become a problem in future.

If Mahalanobis were to view along with the members of the Planning Commission with great satisfaction the achievements of the First Five Year Plan, it would surely have been a mistake but of a lesser magnitude. In fact he has gone to such an extent as to consider that the deficiency of the food supply which has led to the difficulties of the foreign exchange could also be solved by means of industrialization. For instance in an article entitled "Foreign Exchange Problem and Planned Development", he gives a numerical example of various methods of solving the difficulty of food problem from direct import, to direct production of the machines which would increase food production. And then he concludes

To sum up in order to feed the fresh additions to the population at the rate of 5 million persons a year, it would be necessary to provide an additional quantity of 700 000 tons of food grains every year which would require Rs 450 crores of foreign exchange over a period of five years. The cost can be reduced to Rs 135 crores of foreign exchange in a five year period if an additional quantity of 350,000 tons of ammonium sulphate is ordered from abroad every year at least two years in advance of the crop season. The cost can be further reduced to Rs 100 crores (out of which the foreign exchange component would be Rs 60 crores) over a five year period if a new fertilizer factory of 350,000 tons capacity is started every year, this would call for decision four or five years ahead of the crop season concerned. The operational cost of a heavy machine building factory which would manufacture machinery in India to install every year a new fertili-

lizer factory of 350 000 tons capacity would be, however, so small as Rs 12 crores or Rs 15 crores with a foreign exchange component of perhaps Rs 8 or 10 crores. Such a decision will have to be made only once but eight or ten years in advance of the season in which the fertilizer would be used¹⁰

Strange enough that even after pointing out that "such a decision will have to be made only once but eight or ten years in advance of the season in which the fertilizer would be used", it does not occur to Mahalanobis what would happen during these eight or ten years. People cannot go on without food for eight or ten years just because the foreign exchange component of the machines producing the machines for fertilizers would be only Rs 8 or 10 crores. And here that disadvantage of Boehm-Bawerk manifests itself that the roundabout methods are lengthy and provision has got to be made for the consumers' goods during the period which elapses between the installation of roundabout method of production and its results in terms of final commodities.

Various steps of Mahalanobis's model can be considered thus in the first instance a certain rate of growth has been considered as desirable and for that purpose the total investible amount has been so divided that it leads to that rate of growth. Secondly, since the rate of growth considered desirable is to be reasonably high it can be achieved by the production of more and more investment goods. This has been considered feasible by applying the most modern and intensive technique in branch *K*, i.e. the sector producing producers' goods. But lastly, investment in branch *K* is bound to lead to extra purchasing power and increased demand for consumers' goods which are supposed to be produced with simple techniques requiring whatever little capital is left after employing it in sector *K*, and employing more and more labour in these cottage industries. In this way the problem of increased investment and increased consumption has been considered simultaneously and the balance has been supposed to be established between the branches *A* and *C*.

However, from the point of view of long term problem of growth this situation may not give rise to the optimum results

¹⁰ Cf. *Asian Studies*, January 1959, p 13

Because, in the first instance the production of investment goods depends on the surplus which can be generated in the consumers' goods sector. Thus may not be of any great magnitude if the consumers' goods industries are having the least developed techniques. Secondly, the balance between the demand from the producers' goods section and the supply of the consumers' goods section may not be as much as anticipated. The question of the techniques adopted in different sectors of the economy is not independent of the division of investment in the branches *K* and *C*. The maximum possible rate of growth will depend on the maximum possible surplus which can be generated from branch *C*. Thus if we want the maximum possible rate of growth we cannot start from an arbitrarily chosen desirable rate of growth leading to the arbitrarily chosen division between the branches *K* and *C*. Rather we will have to start from the other end and find out the maximum possible rate of growth which can be attained by adopting certain techniques with a certain investment simultaneously determining the division of investment between the branches *K* and *C*. But this brings us to the Marxian model in which very great emphasis has been laid on the investible surplus and how it may lead to expanded reproduction.

MARXIAN MODEL

Marx has divided the whole of the economy into two sectors namely, Department I producing the producers' goods and Department II producing the consumers' goods. In both these Departments the variable capital (capital spent on labour) gives rise to surplus value but some constant capital (that is, capital invested in machinery, raw material and equipment) is needed to extract surplus value from the variable capital. The constant capital *c* is supposed to reproduce itself and not more. The variable capital *v* not only reproduces itself but also creates surplus value *s*. On the supposition that the variable capital creates cent per cent surplus value Marx has laid down the condition of the Simple Reproduction as follows

Department I $4000\ c + 1000\ v + 1000\ s = 6000$ means of production

Department II $2000c + 500v + 500s = 3000$ articles of consumption

in which $Iv + s = IIc$. This means that the labourers who get remuneration for their work in the production of producers' goods in Department I spend their incomes on the purchase of consumption goods produced in Department II. Similarly the capitalists of Department I spend their surplus value on consumption goods produced in Department II. The exchange between IIv and IIs is effected in Department II itself, and the wages of the labourers and the surplus value of the capitalist in Department II are spent on consumers goods alone. The exchange between the capitalists of Department I in the matter of Ic is purely technical and is not important from the point of view of disbursement of income of either the labourers or the capitalists.

The process of accumulation in the Marxian system resolves itself into a positive rate of saving by the capitalists out of the surplus value and its re-conversion into capital on a progressively increasing scale. Under simple reproduction the essential condition of equilibrium is $Iv + s = IIc$. Under the process of accumulation and consequently reproduction on an enlarged scale this condition cannot be fulfilled because a part of the surplus value in Department I must be expended on the constant capital of Department I rather than on Department II. Therefore, in the process of Expanded Reproduction $Iv + s$ would always be greater than IIc .

$$\left. \begin{array}{l} \text{Department I } 4000c + 1000v + 1000s = 6000 \\ \text{Department II } 1500c + 376v + 376s = 2252 \end{array} \right\} 8252$$

In this illustration $Iv + s > IIc$ because a part of s (in this case $\frac{1}{2}$) is assumed to be expended on the additional constant capital of Department I. In that case $1000v + 500s$ (the portion of surplus value which is spent as revenue) is equal to IIc .

The figures can also be manipulated in such a way that the total production of Departments I and II remains the same, that is, 8252 and yet $Iv + s = IIc$ in which case it will be the representation of Simple Reproduction as shown by the following numerical example

$$\left. \begin{array}{l} \text{Department I } 4000c + 875v + 875s = 5750 \\ \text{Department II } 1750c + 376v + 376s = 2502 \end{array} \right\} 8252$$

It is clear that under reproduction on an enlarged scale it is the process of accumulation that is, ploughing back a part of surplus value into constant capital which is of fundamental importance.

The morale of this model lies in two facts, namely, that the process of accumulation and consequently the expansion of the economy would be facilitated and under a capitalistic economy it would be achieved by keeping the consumption of labourers as well as the capitalists at a minimum. And that the greater the surplus which can be generated the greater will be the rate of accumulation. These two facts are so simple and obvious that one finds it difficult to understand how anybody can overlook them. Yet they are often overlooked. The second fact has been overlooked by Mahalanobis in his model of growth already examined. The first factor has been completely neglected by the Planning Commission in laying down specifically as one of the objectives "reduction in inequalities of income and wealth and a more even distribution of economic power",¹¹ and making the Second Five Year Plan an attempt towards attaining higher standard of living in the country. Presumably, this has been done keeping in view the wide perspective of a socialistic pattern of society which has been decided to be the main line of approach. The fact, however, cannot be ignored that in the history of the capitalist world no country has developed without keeping the wage level at the minimum and even in Russia, which has experienced a century later the process of economic growth under very different social and institutional set-up, they could progress only by keeping the level of consumption of the working class exceedingly low.

A socialistic pattern of society is a very fine objective but it has to be achieved under Indian circumstances. Certainly it does not mean equal distribution of income at the very beginning of the developmental process. The Prime Minister in a speech at an informal meeting of the All India Congress Committee on 11 May 1958 has very aptly pointed out

Socialism to some people means two things one, distribution

¹¹ Planning Commission *Second Five Year Plan* p. 24

which means cutting off the pockets of the people who have too much money and, second, nationalization. Both these are desirable objectives, but neither is by itself Socialism. Any attempt to distribute by affecting the productive machinery is utterly wrong. To do so would be to weaken ourselves. The basis of Socialism is greater wealth. There cannot be a Socialism of poverty. Therefore, the process of equalization has to be phased.¹¹

BETTELHEIM'S MODEL

An important variety of the Marxian model of reproduction is the Bettelheim's model of expanded reproduction which has structural similarity with the model of Mahalanobis and is based on the Marxian concept of surplus. Bettelheim starts with the assumption that the ultimate aim of all economic planning is the rise in the standard of living which results from the increased productivity of labour. According to him, employment *per se* cannot be considered as an objective of economic planning unless it is accompanied by rising productivity. He argues that if the productivity of labour increases then it would itself, *via* increasing the surplus to be employed in production, look after the problem of unemployment. The surplus in consumption sector C can be found out by deducting the wage per man year from the gross productivity per man

¹¹ Cf. *AICC Economic Review*, Vol X, No 2, 15 May 1958, p. 4. As regards nationalization he adds: 'Secondly, there is the question of Nationalization. I think it is dangerous merely to nationalize something without being prepared to work it properly. To nationalize we have to select things. My idea of Socialism is that every individual in the State should have equal opportunity for progress. I do not at all prefer State controlling everything, because I attach a value to individual freedom. I do not want State-Socialism of the extreme kind in which the State is all powerful and governs practically all activities. The State is very powerful politically. If you are going to make it very powerful economically also, it would become a mere conglomeration of authority.'

'I should, therefore, like decentralization of economic power. We cannot of course, decentralize iron and steel, and locomotives and such other big industries. But you can have small units of industries as far as possible on co-operative basis with State control in a general way. I am not at all dogmatic about it. We have to learn from our practical experience and proceed in our own way.'

year and multiplying it with the total number of people employed in the consumption sector. If S_c stands for surplus in consumption sector, E_c employment in consumption sector, π_c for gross productivity per man year in consumption sector and w_c wage per man year in consumption sector, then surplus in consumption sector can be written as

$$S_c = E_c (\pi_c - w_c) \quad (1)$$

This relation can also be written as

$$\frac{S_c}{W_c} = \frac{E_c (\pi_c - w_c)}{W_c} = E_c (p_c - 1) \quad (2)$$

When p indicates $\frac{\pi}{w}$ that is ratio between the productivity and wage per worker

In a two sector model where workers in the investment sector (branch J) can get their consumption demand satisfied through the excess of production of the consumption sector over its own consumption the employment in branch J (E_i) will be governed by the surplus in the consumption sector and it can be written as

$$E_i = E_c (p_c - 1) \quad (3)$$

This relation explicitly indicates that employment in the investment sector will depend upon the surplus which can be generated after consumption in the consumption goods sector, and that the greater the surplus the greater the possibility of expansion of the investment sector which in its turn would lead to greater and greater development of the economy

For the sake of simplicity Bettelheim argues¹³ that the total consumption of economy takes place only as a result of employment in branches J and C . As a matter of fact however, the consumption takes place apart from these sectors by the non-working classes and the Government (in the form of social services). If E_s stands for such consumption then it has to be deducted from the total surplus in the consumption sector

¹³ Cf Charles Bettelheim *Studies in the Theory of Planning* (Bombay 1959)

to find out the possible employment in the investment sector, and Relation (3) will have to be written as

$$E_i = E_c(p_i - 1) - E_s \quad (4)$$

Bettelheim, however, mentions this relation by the way and proceeds to analyse further with the help of the more generalized Relation (3). This has some important implications, and the neglect of this relation might lead to some significant results for an economy like India. The minus sign before E_s indicates that the expenditure on services is *only* a liability on the economy. But the fact cannot be neglected that in a country like India expenditure on properly chosen services (which is nothing else but the expenditure on human beings and forms human capital) can bring about an enormous increase in the productivity per worker. And if as a result of expenditure on E_s , the magnitude of p_i increases more than proportionately, the total surplus and hence the potential growth of investment sector will increase rather than diminish. Hence it is a great mistake to neglect this relation altogether.

However, to satisfy the conditions of Relation (3) an equilibrium condition for a two sector model can be written as

$$\partial_i E_i + \partial_c E_c = K \quad (5)$$

when ∂ stands for the ratio between the investment required per worker to the earnings (or consumption when both are assumed to be equal as in this case) per worker. This is almost the same as Marxian organic composition of capital (that is, ratio of constant to variable capital), and K stands for the fund available for investment in constant capital. This fund is the result of the previous productive process and is available at the end of the period of production for allocation between the two branches of production.

Under conditions of full utilization of productive capacities the following relation will be fulfilled

$$F_i p_i + E_c p_c = P \quad (6)$$

when P stands for the new gross product due to the given increase

in employment in the two sectors and the given level of productivity in each one of them. The possible level of productivity in each one of them will depend on the techniques chosen.

Since P is the sum total of P_i and P_c , we can write

$$P_i = E_i p_i \quad (7)$$

$$P_c = E_c p_c \quad \dots \quad (8)$$

Following Mahalanobis, if λ_i and λ_c stand for the portions of K allocated to branches J and C so that $\lambda_i + \lambda_c = 1$, then we can write

$$\partial_i E_i = K \lambda_i \quad (9)$$

$$\text{and } \partial_c E_c = K \lambda_c \quad (10)$$

From the relations (9), (5) and (3), we have

$$\lambda_i = \frac{\partial_i (p - 1)}{\partial_i (p - 1) + \partial_c} \quad (11)$$

and from the relations (10), (5) and (3), we have

$$\lambda_c = \frac{\partial_c}{\partial_i (p - 1) + \partial_c} \quad (12)$$

From the relations (7), (6) and (3), we can deduce the rate of additional gross investment $\frac{P_i}{P}$ (indicated as *ag*) which necessarily results from a given choice of techniques (at a given wage and price level)

$$ag = \frac{p_i (p - 1)}{p_i (p - 1) + p_c} \quad (13)$$

From the relations (9) and (12) it is obvious that if certain techniques are chosen a position of equilibrium can be obtained by having a corresponding distribution of investment between the branches J and C and if on the other hand a certain distribution of investment between the branches J and C is chosen then the corresponding techniques will have to be adopted. Only one

of the variables from the allocation of investment and the method of the techniques can be chosen, the other will follow. Both of them cannot be chosen if the equilibrium condition is to be obtained. It is thus obvious that the long term values of λ_i and λ_c are dependent on the techniques which are chosen and that they are not independent of the wage level. From relation (13) it follows that the rate of gross additional investment and consequently the rate of growth of national income depends upon the techniques which are chosen.

With different values of ∂_i and ∂_c based on different combinations of technology in branches J and C , the following equations will have to be solved :

$$\frac{P_i}{K} = \partial_i + \frac{P_c}{P_c - 1} = r_i \quad (14)$$

$$\text{and } \frac{P_c}{K} = \frac{P_c}{\partial_c(P_c - 1) + \partial_i} = r_c \quad (15)$$

These relations indicate the values of the gross products of J and C obtained with a given investment K . The ultimate rate of growth will depend upon the accelerated value of P_i which can, given wage rate and the organic composition of capital, be increased by adopting the more intensive technique in the consumers' goods industry.

The coefficient r_i which indicates the ratio of the gross investment to the total investment is extremely important, because it is this coefficient which determines the rate of growth of investment and hence the future rate of growth of national income. If the investment in branch J in a certain period is 1, in the next period it will increase to $1+r_i$, in the period t to $(1+r_i)^t$ and the net increase would be $(1+r_i)^t - 1$. Multiplying it by K and noting that the investment will cumulatively increase we can denote P_i in the period t by the following equation

$$P_{it} = K [(1+r_i)^t - 1] r_i \quad (16)$$

This shows that even a small increase in r_i will have a big cumulative effect.

Without any change in the investment pattern the additional production in sector *C* will increase in proportionate relation to the additional production in branch *J*. Hence, we can indicate the additional gross product of branch *C* at time *t* as

$$P_{ct} = K [(1+ri)^t - 1] rc \quad (17)$$

And consequently the total additional gross product will be indicated by

$$P_t = K [(1+ri)^t - 1] ri + rc \quad (18)$$

This formula, however, can be applied to the new gross product obtained from the initial investment *K*. If we assume that the old equipment goes on giving the same additional surplus we can calculate the aggregate additional product in branch *J* at the period *t* as

$$P_{jt} = Y_{j0} \alpha_0 [(1+ri)^t - 1] ri \quad (19)$$

when α_0 stands for the rate of initial net investment to the initial gross product Y_{j0} .

Similarly, we can get the following equation for the aggregate gross product of branch *C* at time *t*

$$P_{ct} = Y_{j0} (1 - \alpha_0) + \alpha_0 \left\{ \frac{(1+ri)^t - 1}{ri} \right\} rc \quad (20)$$

and the aggregate gross produce at time *t*

$$Y_{gt} = Y_{j0} (1 - \alpha_0) + \alpha_0 \left\{ \frac{(1+ri)^t - 1}{ri} \right\} (rc + ri) \quad (21)$$

This equation indicates that long term rate of growth depends on the rate at which the investment goods increase. It may also be noted that consideration of the employment problem should not lead to the adoption of the relatively backward techniques in the consumers' goods sector, because ultimately it is the surplus from that sector which can sustain the great increase in the investment goods' sector. In an underdeveloped country, says Bettelheim,

unemployment is the legacy of the past and is due to the fact that the rate of investment goods was not high, and it can be remedied only by increasing the rate of investment goods.

This model is in essence based on the Marxian model of expanded reproduction with the specific difference that in Marxian case a part of surplus value is needed for the consumption of the capitalist class, whereas in this model whatever is left after the minimum consumption of the labourers (minimum because the level of earning has been supposed to be equal to spending) is supposed to be accumulated. The danger of leaving out the expenditure on services in the context of an economy like India has already been pointed out. Moreover, in an economy where the socialistic pattern of society does not mean 'concentration of all powers in the hands of the State' but decentralization of production with a specific place assigned to the private capitalists the necessity of the consumption of the capitalist class can hardly be left aside altogether. A model of expanded reproduction of Sweezy's¹⁴ type is of a greater approximation to reality in the context of conditions in India than that of Bettelheim.

In fact Bettelheim has elaborated his model in relation to the conditions of a centrally controlled economy, and has himself accepted the limitations of his model so far as its applicability to the conditions of India is concerned and so long as the social and institutional set up here remains the same. He frankly admits that so long as the conditions assumed in his model are not satisfied a great part of his analysis will have to be modified. But to me it seems that there are certain implicit assumptions in the analysis about India the foundation of which is so shaky that it would require a drastic modification of the whole scheme, and ultimately it would turn out to be a difference of kind rather than of degree. For instance he seems to have assumed the working of the forces of a capitalist system in the entire economy with the modification that they are not very active. He suggests that the vast amount of unemployment in the country is due to the fact that the rate of investment is not very high and it is only by increasing the rate of investment that unemployment can be eliminated altogether. In fact unemployment in India is basic-

¹⁴ Cf. Paul M. Sweezy, *The Theory of Capitalist Development* (London, 1949) pp. 163-4.

ally due to the disintegration of the older type of society and the simultaneous lack of expansion of the market economy. Therefore if there is something which leads to further disintegration of the subsistence economy at a greater speed than the development of the economy, unemployment will increase and not diminish. Again, with the early stages of development the death rate will diminish without having any significant effect on the birth rate and consequently there will be an increase in the labour force. Hence with the remedy which Bettelheim suggests, unemployment will increase rather than diminish. The conditions in India at present are like the ones prevailing in the now advanced countries especially England before the Industrial Revolution when the disintegration of the feudal society led to a great addition to the labour force and the development of capitalist society did not have the momentum to absorb that population. No wonder Marx so much emphasized the "army of unemployed labour". The question of unemployment in India cannot be dismissed as merely temporary, which would take care of itself with the progress of the economy.

Another great difficulty with Bettelheim's model is that he assumes the conditions of India as very much alike the ones prevailing on the eve of Industrial Revolution in the now developed countries. In these countries the industrial revolution was preceded by an agricultural revolution which created a base for the industrial development. We have had no base of this type even now we are not in a position to have such a base.

Yet his model is a great improvement on that of Mahalanobis in that it emphasizes that the question of the technique and that of the allocation of resources are inter-dependent and the ultimate rate of development depends on the capital formation and the rate at which the investible funds increase.

SCHUMPETER'S MODEL

It is now time for us to consider the Schumpeterian model of economic development in relation to the problems of economic growth of India. Elsewhere¹² I have examined this model at great length and it is not necessary here to enlarge upon it.

¹² Mohd. Shabbir, Khan, *Schumpeter's Theory of Capitalist Development*, (Muslim University Aligarh 1957).

However, the essential features of the model are quite simple and are described below

Schumpeter starts with a closed commercially organized system in which private property, division of labour and free competition prevail. Then he proceeds to describe a system of stationary equilibrium in which the demands of the consumers determine what would be produced and the supply creates its own demand. The system has been constructed on the Walrasian technique of general equilibrium in which the production function is given and is invariant in form. This is designated as circular flow of economic life which reproduces itself with the same magnitude of economic quantities. It does not mean that the system is motionless, on the other hand, it flows on quite smoothly and is also capable of absorbing marginal adjustments which take place in the given production function. More specifically, Schumpeter suggests that there are slow changes of savings and of the rate of increase of population which are smoothly absorbed into the system. This system is characterized by the absence of any fundamental and drastic change which may disrupt the stationary equilibrium and may require painful adjustments leading to another state of equilibrium.

It may be noted that the development of Indian economy during the four or five decades preceding the planning period had been taking place in a way which can characteristically be described with this technique of circular flow of economic life. For instance, in the *First Five Year Plan*, the Planning Commission observes

In the last four or five decades, there has been considerable industrial development in India, accompanied by urbanization and expansion of commerce. Large towns and cities have grown and transport and communications have developed extensively. Indian enterprise has made considerable headway and the country has now considerable experience in the fields of modern business, industry and finance.¹⁶

Although the process of growth which has taken place in India during these decades can be well described by the circular flow of economic life with its broad implications that the station-

¹⁶ *First Five Year Plan* p. 12

ary process has been absorbing the changes of accumulation and population, yet it can by no stretch of imagination be called a vicious circle of poverty and stagnation. Certain writers on the problems of growth in underdeveloped countries have greatly emphasized that there exists a vicious circle at a low level of equilibrium of poverty, lower productivity, lower income, lower demand and hence again poverty. Nurkse has, I think, committed an error in associating Schumpeterian circular flow with what he describes as the vicious circle in underdeveloped countries. He is right in suggesting that the problem of economic development in underdeveloped countries can hardly be understood without making specific reference to the great work of Schumpeter. But Schumpeter never started with the vicious circle or stagnation and to start from a vicious circle and invoke his system is untrue to his spirit. Moreover, there has been no stagnation, at least in Indian economy, of the type described by Nurkse. The great difficulty is, as Bauer suggests, that the low level of income which prevails at the moment in underdeveloped countries has been misunderstood to imply a zero rate of change in income. It has been thought that since the level of income is low it could hardly have been lower in the past. Low level of income can be co-existent with quite a satisfactory rate of growth if the growth has started only recently.

Myrdal has gone a step further to suggest that the vicious circle indeed implies a cumulative downward causation and hence contraction. He seems to have invoked the great principle of Bible—"Unto everyone which hath shall be given and from him that has not, even that he hath shall be taken away from him"—to the functioning of the economic system in its internal and international aspects. He then suggests that the "back-setting" effects of the developed countries lead to deterioration and further deterioration of the underdeveloped countries, and since the poorer the country the weaker the "spread" effects, there are no advantages whatsoever gained by the underdeveloped countries from the expanding regions of the world. That this does not bear the test of observation and historical facts in India needs no elaboration. As such the concept of vicious circle can hardly be made use of in considering the problem of economic development of India.

On the other hand, we cannot agree with even Bauer that mere

wants on the part of consumers are capable of bringing about rapid economic development in underdeveloped countries. The marginal adjustments which can take place because of the variety of wants on the part of consumers are insufficient to bring about economic development of any important magnitude. Besides, it has never happened that the consumers have shown any effective demand for a new commodity or a new method of production and then the productive system has been adjusted to it. It is the *entrepreneurial spirit* as emphasized by Schumpeter which has been responsible for changing over from the old combination of productive services to the new ones, and the consumers have been made, by advertisement, etc. to want the commodities produced by them. The domain of consumers' sovereignty is bounded by the stationary equilibrium. A real dynamic economy starts from the other end. It is not the marginal adjustments but the structural changes which go with the process of rapid economic development needed for a country like India.

It is, however, impossible for the individual entrepreneur to bring about these structural changes with any great rapidity. Were it possible for them they would have done it. The fact that they did not do it clearly indicates that there is a great difference between the individual marginal productivity and the social marginal productivity in underdeveloped countries. There are certain overheads which are not in the interest of the individual entrepreneurs to provide. For instance, it is not in the interest of any individual entrepreneur to construct electric and power plants, build dams, roads and railways and construct the base for the industrial enterprise at the moment in India. But if that could be done, as is being done by the State, a great expansion is made possible by individual entrepreneurs. Then there would be the possibility of Schumpeterian entrepreneurs and their followers to bring about waves of innovations and economic development. This would also lead to the external economies for each individual entrepreneur—external not only in the Marshallian sense in which the cost in a firm is dependent upon cost in other firms, but also in a wider sense in which the profits of one firm are dependent upon the others.

But profits are determined by cost as well as revenue, and if the revenue side affects the profits then it is the emphasis

on the market conditions. It is the broadening of the market which is then the focus of attention. It has been aptly pointed out that the amount of investment is determined by the extent of the market. It is indeed a revised version of Adam Smith's famous dictum that division of labour is limited by the extent of the market.

Emphasis on the expansion of the market, and the entrepreneurial activities have led some economists to think in terms of what is known as the balanced growth. It has been suggested that although it is not possible for the individual entrepreneur to produce any one commodity in any significant quantity through large-scale production because there would not be enough of demand for that commodity, but if many entrepreneurs produce many commodities of different varieties then the supply of one will create the demand for the others and it will become profitable for all of them to produce. This reasoning, however, is based on an implicit assumption that there already is provision for a very elastic supply of at least some goods, notably the agricultural commodities which are basically required, because with the expansion of the market and the economy the first impact of the increase in demand would be on food. Hence, although there seems to be a lot of truth in the argument of balanced growth the prerequisites are the provision of overheads, and the provision of enough food.

The argument for balanced growth should not necessarily lead to the distrust of market forces and the overall control by the State. It is indeed the duty of the State to break the rigidities and make possible the free working of the market forces. State can help enormously in bringing about entrepreneurial spirit and initiating economic development. But the State does not have to take an overall control of the whole economy. Reference may be made to the statement of our Prime Minister to the effect that the State has already many duties to perform in the political sphere and if it also takes up the economic power in its hands it is bound to become a conglomeration.

What is really needed is some sort of force which may lead the economy from the "take-off" growth to the "self-sustained" growth. In this process it is necessary that some group or authority brings about new productive techniques and this group becomes more and more important. The State can help enor-

mously in initiating economic development and provide facilities for expansion of the economy, but it does not have to do everything. If the spirit of entrepreneurship has been created then the profits can easily be ploughed back for purposes of accumulation and the economy can go into the self-sustained growth. But in creating facilities the State has got to be careful lest it should spend excessive amount on overheads and the public works. The only thing which is required is some sort of ground on which the entrepreneurial spirit can work.

I do not agree with the suggestion that State planning in the underdeveloped countries would mean the reversal of the Schumpeterian model. In fact Schumpeter's model works effectively. But since that system is being applied to different institutional and social circumstances from the ones which Schumpeter had in mind, his system has to be modified to that extent. It is untrue to say that whether the entrepreneurial spirit is in the hands of private individuals or in those of the State, is only a question of method. It is much more than that. It is necessary to take into consideration the market forces and their adjustments in the long run. Otherwise, there will be the problem of imbalance between various sectors and regions and unnecessary waste which can easily be avoided. We shall have occasion to discuss at length the policy of the Indian Government in its efforts towards creating entrepreneurial spirit in the country and at this stage we do not have to go into details. But one thing must be mentioned that one need not be dogmatic about State planning by a centralized planning authority or a free enterprise without any interference. In fact modern capitalism has got an enormous capability of readjustment and in the socialistic pattern of society we should not discard it altogether simply because we want to do so.

* * *

It will not be out of place to discuss a little the question of agriculture versus manufacture before closing this chapter. Great confusion has been created, as we have seen, by considering the circular flow incorporating marginal changes in accumulation and population as a vicious circle of poverty and stagnation. It has often been suggested that since India is primarily an agricultural country, caught in the vicious circle, there is an inherent

relationship between agriculture and stagnation. Therefore, the only way of coming out of this vicious circle is to industrialize. There is absolutely no doubt that development of the country ultimately means widespread manufacture but none of them can be considered as the cause of the other. We have seen that both development and manufacture can be the result of entrepreneurial spirit, managerial skill and hard and disciplined work on the part of the labouring class. Moreover, note has to be taken of the fact that everywhere industrial revolution has been preceded by agricultural revolution. This needs special emphasis because after having been under colonial rule for a considerable period of time we have all come to have an irrational hatred towards agriculture. As we have analysed in the early stages of economic development there is a great necessity of expenditure on overheads and agricultural improvements to establish a sound base for further development. As a matter of fact it is wrong to pose the real question by asking whether we should have agriculture or industry. It is not the question of agriculture versus industry; it is indeed a question of *agriculture and industry*. In the underdeveloped countries both are poor and both have to be developed. India is considered primarily an agricultural country not because we have a very developed agricultural system but only because a vast majority of our population hang around agriculture. It has been aptly pointed out that India will have to develop, at least in the early stages of its economic development, along the lines of the advanced primary producing countries.

I may anticipate at this stage a possible objection to the above reasoning. This would be on the ground that development of manufacturing industry could be based only on a progressively developing agriculture. It may as an answer, be said that one would be doing an injustice if the development of manufacture in the context of Indian economic development is not emphasized. But the development of manufacture will itself depend on a considerable amount of surplus of food which can be obtained for feeding the increased employment in the industrial sector. Moreover, as we shall see in the next chapter, the development of agriculture and other primary products in the early stages would be needed to make them available as exportable surplus with which capital goods can be imported into the country.

PROCESS OF ECONOMIC GROWTH

It is therefore suggested that the State must try to remove all bottlenecks which lie in the way to progress of agriculture. Land reforms must receive top priority for breaking up the subsistence economy and paving the way for incentives to develop agriculture. The underdeveloped countries will have no great advantage in concentrating on the types of industries which have already been developed in the now more advanced countries. There will have to be a lot of research and I must emphasize that it can be done only within the underdeveloped countries for the development of technology and the development of light industries.

We have already noted and shall discuss the matter at length about the difficulties which have been created in the balance of payments during the Second Five Year Plan because of the shortage of agricultural products. We may reasonably want industrialization but industrialization is no remedy for poor agriculture.

CHAPTER II

INTERNATIONAL TRADE *VERSUS* AUTARCHY

IN the last chapter we examined various models of economic growth from the point of view of the closed economies. However, in the case of comparatively free societies a large part of their economic activity is related to foreign trade. We, therefore, proceed to consider the question of foreign trade in relation to the economic development of a country. More specifically, we would be concerned with the problem whether foreign trade or autarchy would be more suitable as an economic policy leading to the accelerated growth of our economy. But before we do that it would be interesting to consider the implications of foreign trade in the various models of growth discussed.

The Harrod-Domar model of growth introduces foreign trade in a perfunctory way and formally that has been done quite easily. Foreign trade has been introduced to the growth equation as a foreign account counterpart of savings. We may, for instance, write P for all the debit items on current account and Q for credit items. Then we can deduct Q from P and relate it to the level of income to find out the ratio of foreign balances to the level of income and call it b . Then the growth equation will be written as

$$\partial = (a + b) \beta - r$$

It is obvious that if b is positive then the possible rate of growth of income would be higher than it could be in the absence of the world trade, and conversely if b is negative then the possible rate of growth of income would be lower than it could be.

It is difficult to generalize what would be the magnitude of b if the foreign trade is left free to itself, but it is obvious that by means of some policy the magnitude of b will have to be increased to accelerate the rate of development from the one which was possible with the help of domestic savings only. This would mean that in the early stages a country would be a borrowing-debtor country and would be having an increasing import sur-

plus As the process of take off changes into that of self-sustained growth this country would become a paying-debtor country Then its import surplus would not only decrease but vanish, and its export surplus increase How all this would be done will be considered in detail in the next chapter when we discuss the question of international flow of capital

Mahalanobis also could have incorporated the question of foreign trade by introducing λf , which would have meant the coefficient of the investment goods which could be imported into India to accelerate the economic development But he starts with the *assumption*, that, "with the progress of planning the domestic supply of investment goods would become more and more important That is, although in the beginning India will no doubt have to depend on imports of capital goods, the policy would be to make India independent of such imports as soon as possible In the present model I have therefore assumed that there will be no imports or exports of investment goods"¹

Thus we see that although he could have introduced international trade in his model he did not do it deliberately His idea was not that India would not purchase any capital goods from abroad but only that India would manufacture and also export capital goods so that it would virtually mean that she would balance the exports and imports

The case of the Marxists is altogether different They start by assuming that the fully capitalist economies would be liable to greater and greater fluctuations and therefore it would be in the interests of underdeveloped countries to keep their economies completely closed That is why neither Bettleheim nor Sweezy introduces any foreign trade into their models

As regards Schumpeter we all know that although he developed his system with reference to a closely commercialized country, yet he incorporated international trade as one of the most important elements leading to economic growth He considers not only the introduction of new goods, or a new quality of goods, the introduction of a new method of production the introduction of new organization of industry but also the conquest of new sources of supply of raw materials or half manufactured goods and the opening up of new markets as acts of innovations which are essential for bringing about development in an economy

¹ Sankhya p 25

Myrdal, however, does not think that the free forces of international trade lead to economic benefit and the development of all the participants. According to his theory the vicious circle of cumulative causation applies to the international economy just as it does to the inter-regional economies. He invokes an idea from his study of the Negro problem in the United States that the more developed a country is the greater would be the advantages and conversely the less developed a country the less would be the advantages from the operation of international trade. This goes on happening cumulatively so that the developed countries go on developing more and more, and the underdeveloped countries go on becoming poorer and poorer. It is because, Myrdal argues, in the case of the developed countries the "spread effect" gives rise to the benefits and these effects cannot spread easily in the underdeveloped countries. Rather there are "back-setting" effects in the underdeveloped countries which lead to cumulative deterioration. He even goes to the extent of suggesting that the whole question of the stable equilibrium in relation to the theory of international trade as well as general theory should be scraped off, and a technique of cumulative expansion and contraction should be adopted to explain the phenomenon of the underdeveloped areas.

I do not have enough competence to discuss the question whether in the United States the condition of the Negroes has been deteriorating. Simple observation suggests that it is the late start in the educational and cultural development of Negroes which makes the difference between them and the Whites so obvious rather than the cumulative deterioration of the Negroes. Yet in the field of economics it can be said with a degree of confidence that Myrdal's thesis does not bear the test of practical applicability. The industrial revolution in the case of underdeveloped countries has been considerably delayed which explains the slow rate of progress of these countries. There has been no cumulative tendency towards deterioration. No wonder that in none of the three books* in which Myrdal has elaborated his concept of cumulative causation and vicious circle has he been

* *An International Economy—Problems and Prospects* (New York, 1956) *Development and Underdevelopment* National Bank of Egypt Fiftieth Anniversary Commemoration Lectures (Cairo, 1956), *The Theory of Underdeveloped Regions* (London, 1959)

in a position to find a realistic example to start with. He has had to start with a situation in which a factory established in some region is burnt by some misfortune. He then tries to find out the various repercussions of this misfortune. It is indeed a very difficult task to find a realistic example for a theory which has a shaky foundation.

However, there are two methods which can be followed in the process of economic development. One is the Russian model without any particular reference to institutional or social conditions, but in the sense that goods are produced in all stages of production within the country so that a country produces everything it uses, and the international trade is adopted so far as it is absolutely essential and also under strictly controlled conditions. The other method is the one in which the countries take into account the advantages which might arise from the division of labour not only in the static sense when the resources are given but also in the dynamic sense when the development of the potential human and material resources leads to the dynamic concept of comparative cost.

There are obvious disadvantages in following the Russian model. No country with the exception of the USA could afford to develop with the minimization of foreign trade. It is perhaps due to the continental character of the country that it has been possible for the people there to produce everything of their own without much consideration of international division of labour. And there is no other country in the world except Russia which could adopt the United States as a model for its development. It is again because of its continental character that Russia can do it. Otherwise there are great many advantages which can be derived from international trade and no country can do without it but by bringing an enormous amount of misery to its people. One very important consideration of development along the lines of the division of labour is that it is possible to borrow capital from international markets without which the speed of economic development is bound to be very slow. It is, therefore, obvious that in the process of economic development countries can derive enormous benefit from international trade. National economic planning should not be inconsistent with the expansion of international trade.

In the beginning of economic development capital goods

have got to be imported which in the absence of assistance from abroad, can be done either by putting restrictions on the imports of consumers' luxury goods or by promoting exports

Putting of restrictions on the imports of luxury consumers' goods in itself does not imply that to the extent that imports have been curtailed the capital has been accumulated. Import policy must be accompanied by the domestic act of saving. Otherwise, the restrictions on imports would not lead to the benefit postulated. If the people voluntarily or otherwise do not save the income which they could have otherwise spent on the import of the consumers' goods their demand for the existing goods of the economy would increase. This in itself does not entail the increased supply of the goods available at least, in the short run which would lead to inflation. All of us know that although inflationary pressure is a necessary accompaniment of the process of economic development, inflation as such is very harmful because it leads to undesirable encouragement to speculation, expansion of unnecessary commodities and encouragement to inefficient production. By the process of inflation some forced saving is bound to take place but that is not a desirable way of saving. Therefore, if the restrictive policy on the imports of luxury consumers' goods for the sake of importing capital goods is adopted it must be accompanied by some judicious fiscal policy which would help save the extra income spent on the imported goods. Obviously this act of saving is quite easy in a completely planned economy where the consumption of the people can easily be curtailed but it is very difficult in the case of a mixed economy where private forces are given considerable scope to function.

Another alternative and/or complementary method of enabling a certain country to import capital goods is export promotion. It is necessary for the underdeveloped countries to promote in the early stages of economic development the export of food and raw materials. These are the only commodities of which the exportable surplus can easily be increased as they have a low capital coefficient and with a small expenditure on capital their production can be increased more than proportionately.

It is neither possible nor very desirable to consider the question of export promotion of raw materials from the point of long term objective. There are various reasons why it is not

possible to promote the export of raw materials to any great extent in the long run. First, there are a series of innovations taking place in the more developed countries which lead to the use of synthetic substitutes and diminish their dependence on the imported raw materials. Secondly, there is sometimes a deliberate policy by the now advanced countries of changing the composition of output and making the country less and less dependent on the raw materials from the underdeveloped countries. Finally, even on the assumption that there are no such impediments for the trade of raw materials of the underdeveloped countries it is obvious that the growth of the income of the now developed countries would take place at a slower rate and a greater portion of the increasing income would be spent on the so called tertiary industries. This would mean that even if the demand for raw materials by the advanced countries increases in future it will increase only at a diminishing rate. On the other hand, the demand for capital goods by the underdeveloped countries which have started developing would increase at an increasing rate. Therefore it will not be possible to satisfy their demand for capital goods only from the proceeds of the exports of the raw materials.

To start with, however, efforts will have to be made to increase the export of raw materials. Efforts may also be made to increase the value of the goods which are exported by means of processing and improvement of their quality, etc. At the same time research can be intensified for purposes of giving rational guidance in the matter of diversification of exports and spread over a wider range of commodities. There is a considerable scope for increasing the exports of cheap manufacturing goods which are at present not manufactured in the developed countries. By means of research further possibilities can be explored of developing light engineering industries and electronic goods which have low capital output ratio and the production of which can be increased fairly easily.

Sometimes such diversification of exports is suggested because it is said that prices of raw materials fluctuate much more during the trade cycle than the prices of the other commodities. There are some theoretical reasons as to why this happens. First, the prices of the raw materials fluctuate to great extent because the factors of production used are generally so specific that they can-

not be adjusted easily to the fluctuations in the demand for the commodities. Therefore a reduction in their demand during recession and depression leads to the fall in their prices rather than a reduction in the supply. Secondly, the manufacturers want to maintain a fixed relationship between the working stocks and the production of the commodities and therefore when the consumption of those commodities diminishes there occurs a greater reduction in the demand for the raw materials. Finally, the speculative business in the inventories often aggravates fluctuations in the demand for the raw materials rather than diminish them.

It may be argued that if the prices of the raw materials fluctuate much more than their demand then the raw materials producing countries would gain during prosperity as they lose during depression. But such an argument is rather fallacious specially when we consider the question in relation to the programmes for economic development by the underdeveloped countries. Such programmes require that there must be a continuous flow available for financing the projects of economic development. On the other hand, during the period of recessions when the prices of the raw materials diminish it can have no effect on the consumption of the people as it is already at a minimum and consequently the programmes of economic development are adversely affected.

In view of the seriousness of the problem the UN Committee on Measures for Full Employment was asked among other things to consider this question in detail and suggest remedies for stabilizing the plans of economic development of the underdeveloped countries. It has been recognized by the Committee that the development of the underdeveloped countries should be an integral part of the measures for full employment in the present-day advanced capitalist countries. And since the fluctuations of the prices of the raw materials affect the programme of economic development of the underdeveloped countries it has suggested two specific measures by which the disadvantages can be minimized. In the first place those countries which experience fall in exports or in the prices of exports because of the recession elsewhere it suggests, should be entitled to a special supplement of foreign exchange made available to finance their deficit by the country where the recession originated. This loan or

deposit should be repayable only if the giver country wants to increase its balances and the country which has taken the loan wants to diminish them. Its second suggestion is that the programmes for lending of capital should be fixed up five years ahead and any deficiency which might arise due to the private agencies shrinking their lending during recession should be made up by the International Bank for Reconstruction and Development.

These suggestions are rather difficult to implement because it is recognized fairly widely that in future because of the specific social and institutional conditions of the United States and also because of the predominantly great role of America in the non-Communist world, any recession in the underdeveloped countries would come as a result of the original recession in the United States. And it is hardly possible for the United States during recessions to give special supplement of foreign exchange to all the countries of the world.

The programme of lending which was suggested to be fixed up five years ahead involved many administrative and practical difficulties. If the objective ideal is to develop an international market for lending it cannot possibly be controlled and no one can anticipate the programme of lending for five years. We shall have an occasion to discuss the objectives and activities of the IBRD in a later chapter but right now it can be pointed out that it is difficult for the Bank to make up the deficiency of all private lending during recession unless the Bank's resources are very significantly expanded. Moreover, the Bank has to float its loans in the free market and under general conditions of depression in the economic activity it is not possible for it to collect enough funds to make good the deficit of the underdeveloped countries.

Therefore, the UNO appointed another Committee on Measures for International Economic Stability. One specific term of reference of this Committee was to consider the question and make special recommendations for the difficulties of the underdeveloped countries which arise due to the fluctuations in the prices of raw materials. This Committee put forward some alternative suggestions more amenable from the point of view of practice and administration.² It suggested that the problem

² UN Department of Economic Affairs *Measures for International Economic Stability* (New York 1951) p 10 ff

of the fluctuations of prices must be directly attacked and for that purpose the need for the international commodity agreement needed hardly any emphasis. It did not commend any controlled price parity because it would have meant a permanently controlled world economy and its advantage would have been greatly reaped by the advanced countries which produce a greater part of the total raw materials.

It did not think that there was any specific need for the programme of lending to be fixed up five years ahead. A more practical suggestion was that the IBRD should be prepared in the event of a recession to expand greatly the flow of its lending to fill up the gap between the requirements of the underdeveloped countries and the availability of capital. It suggested three types of cases in which the IBRD could help the underdeveloped countries. The first type of the programme for which the IBRD was suggested to extend its lending is the one which was previously agreed upon by the IBRD and the underdeveloped countries concerned and in which the IBRD was giving partial assistance. In such a case if the country in question faces any difficulty as regards finances during recession the IBRD would be bound to expand its lending. The second type of cases are those in which there has been an agreement between the IBRD, private foreign capitalists and an underdeveloped country and for which the IBRD as well as the foreign capitalists were extending finances. If in such cases the private capitalists diminish their lendings the IBRD would be required to supplement it. The third type of cases are the ones in which there is no previous agreement and in difficult situations the Bank would be called upon to consider their cases for help provided the Bank has some finances available for assistance.

The third recommendation of the Committee was that the resources of the IMF should be considerably expanded so that the Fund may help in stabilizing foreign exchange during the recessions.

It is to be noted that all these recommendations have certain limitations. The international commodity agreement is very difficult to arrive at in view of the fact that there is always some difficulty or the other in finding out the ideal price which can be determined. Moreover, it is not possible to have such agreements in the case of all commodities and therefore some specific

countries which are interested in specific commodities might not benefit from such agreements. Therefore a greater reliance will have to be made on the recommendations in regard to the IBRD's lending and IMF's finances. There is need for increasing the resources of these institutions to a very great extent.

Happily these difficulties are mitigated at least to some extent, because in future no great depression of the type of 1930's is expected. All experts agree that there would be only mild recessions and whenever such recessions take place the recovery will not only be round the corner but will actually be in full view. The underdeveloped countries therefore are not likely to face any crisis.

As a matter of fact there is no remedy for an evil except doing away with the cause of the evil itself. These suggestions can be considered, I think, only as stop-gap arrangements. The real cause of the fluctuations of the prices of commodities is the lack of resourcefulness of the underdeveloped countries. And as such the real remedy would be the diversification of the economy which can come about through the process of economic development itself.

Apart from the fluctuations in the prices of raw materials, sometimes the question is raised of the long-term changes in the terms of trade between the raw materials and the manufactured commodities. The famous League of Nations' *Study on Industrialization and Foreign Trade* has ventured to suggest that there has been a downward tendency of the terms of trade in the case of the raw materials and thus the terms of trade have continually deteriorated between 1873 and 1937. These findings have been quoted again and again by the various committees appointed by the United Nations. Whereas there is no doubt that the underdeveloped countries are well advised to diversify their productive structure and also the foreign trade, there is no reason why unnecessary emphasis should be laid on this so-called adverse terms of trade for the primary goods. Secular downward trend of the terms of trade is a very unscientific expression because the definition of the terms of trade as applied to long period is one of the most complicated matters and its statistical measurement is exceedingly difficult. There must have been a considerable change in the composition as well as the quality of the commodities and a base as far back

as 1873 loses all significance. Moreover, a general comparison between the primary goods and the manufactured goods is not very relevant for the underdeveloped countries as many advanced countries themselves produce raw materials and their magnitude is no less significant. Finally, different countries are interested in particular commodities only and as such any general comparison loses its significance from the point of view of individual countries.

It is, therefore, not a very scientific procedure to rely very much on the findings of this sort and then suggest that there is no scope for the underdeveloped countries to advance on the lines of the advanced primary producing countries. The fluctuations of the prices during the trade cycles are a sufficient cause for the underdeveloped countries to diversify their products, a long term deterioration of the terms of trade is an unnecessary auxiliary. The vulnerability of the underdeveloped countries is due to their underdevelopment for which obviously the remedy is the struggle for development. But there is no virtue in developing in any one way or the other. A country must try to develop on the lines in which its potential resources give a comparative advantage.

This brings us to the question of protection in the short run. Temporary interference with the freedom of trade can develop new skills and aptitudes and can bring dormant resources into active use. No capitalist country has ever followed completely free trade. Time and again in the process of their economic development the capitalist countries have been advocating what is generally known as the infant industry argument meaning thereby that temporary protection of such industries would give them facilities to expand and a comparative advantage over other countries. Temporary interference therefore in the freedom of trade from the point of view of economic development is not at all incompatible with the theory of comparative costs.

The classical theory of comparative cost was developed from the point of view of static resources and their allocation to the best possible advantage. It is so to say correlated to the stationary equilibrium in which only marginal adjustments can be made. Emphasis on dynamic studies which are an essential element of the developing economies has brought about a dynamic concept of the theory of comparative costs and it is related to the development of human and material resources.

Ganguli⁴ has shown that the concept of the dynamic theory of comparative cost is not simply a theoretical possibility. In the development of India's foreign trade certain elements like World War II, partition of the country and the developmental needs have brought about a significant change in the composition of India's foreign trade. Before World War II nearly 40 per cent of India's foreign trade was with the countries which subsequently became enemy or enemy occupied countries. These countries used to absorb 75 per cent of India's exports of raw cotton, 60 to 70 per cent of iron and steel, metallic ores and coal, nearly 50 per cent of the exports of oilseeds, raw jute, cotton manufactures, tobacco and vegetable oils. The war disrupted this channel of trade and the question which the Indian economy had to face was to absorb these exportable surpluses or find new markets for them. The food shortage and the consequent "Grow More Food Campaign" provided an opportunity of diverting the land from cash crops to the production of cereals. And the needs of the war economy made it possible to absorb the surpluses of oilseeds, pig iron and other minerals. The partition of the country in 1947 which caused a large part of the cotton and jute growing and food surplus areas to go to Pakistan made it necessary for India to import raw materials and food. This resulted in the stepping up of manufactures for providing exportable surplus so that the required food and raw materials could be imported. The launching of the Plans for the economic development of the country made it imperative to import capital goods from abroad.

Thus the war, the Partition and the development needs, all combined to bring about a fundamental change in the composition of India's exports and imports. Consequently in 1951-52 exports of manufactured goods formed 56 per cent of the total exports of India, compared with only 30 per cent before World War II. The percentage share of imports of food in the total imports has increased from 14.1 in pre-war years to 26.9 in 1951-52. The percentage share of imports of raw materials has increased from 22.7 to 36.50 per cent, and the

⁴ Cf. B. N. Ganguli, *India's Economic Relations with the Far Eastern and Pacific Countries in the Present Century* (Bombay, Calcutta, Madras, 1956). This paragraph draws heavily on this contribution.

percentage share of imports of manufactured products has declined from 61.6 to 35.8 during the same period.⁵

This shows that temporary interference with the freedom of trade can bring about new resources and new commodities will ultimately have comparative advantage. Thus the theory of protection does not necessarily discard the old concept of the theory of comparative cost but puts it into a dynamic setting.

Protection may be adopted with different objectives. First, as we all know, developmental process is always accompanied by deficit balance of payments because of the great need of the underdeveloped economies to import capital goods. Unless, therefore, there is a flow of foreign capital from outside, the country can try to preserve foreign exchange balances by putting restrictions on the free imports of luxury goods. (We have already noted that they should be combined with the domestic act of saving to get the full benefit of protection.) Secondly, the objective might be to shift the demand for certain imported commodities to that of the commodities manufactured at home. For this purpose it may be necessary to put restrictions on the import of manufactured commodities. Thirdly, there is an absence of industrial base in an underdeveloped economy which can be established only by giving protection to certain industries in the country. Finally, there is the important objective of absorbing the surplus labour in the production of the commodities inside the country even when it means that the commodity manufactured at home may cost higher than the one imported from abroad.

A well devised policy of protection does not necessarily lead to autarchy. By means of the protective method it becomes possible for the economy to enlarge its market and resourcefulness. The dormant resources are brought into active use and lead to greater and greater productivity and ultimately to the expansion of the world trade.

Viner is, however, very sceptical⁶ about the scope of protection and also the benefits which an underdeveloped country can expect to reap by adopting it. He argues that for the justification of protection the following four conditions are neces-

⁵ *Ibid.* pp. 9-17.

⁶ Cf. J. Viner, *International Trade and Economic Development* (Glencoe, Illinois, 1952) pp. 57-8.

sary First, the reciprocal demand of the outside world for the commodities produced at home vis a vis its own demand has low elasticity so that the outsiders cannot easily dispense with the commodities exported Secondly, its own reciprocal demand for the commodities imported vis a-vis the outside countries has got a high elasticity so that it is possible for the home country to relinquish the imports easily Thirdly, there is no retaliation by the outsiders to the protective policy of the home country since otherwise the home country would not only not reap the advantages of protection but might also have to suffer because of the retaliatory movement And finally, the protection is administered with a high degree of efficiency to achieve the full benefit of the policy

It is thus shown that although there is no theoretical objection to the policy of protection adopted by an underdeveloped country from the point of view of its economic development, there is a very narrow limit within which it can gain from such a policy It can, however, work to the great advantage of the underdeveloped country if the attitude of the outside world, especially the countries playing a predominantly important role in foreign trade is sympathetic towards adoption of such a policy If the underdeveloped countries develop on the lines of primary producing countries and develop their manufactures of light-engineering industries and electronic goods, there is no reason why the present-day advanced countries, especially the USA, should not have a sympathetic attitude towards them And thus there is a considerable scope within which the productive policy can be adopted with great benefit

It is sometimes suggested that in economic planning there is enormous incentive to move towards autarchy and deprive the country of the benefits of foreign trade The main reason for doing this is that while it is possible for the planning authorities to calculate or at least forecast the repercussions of the various measures which are undertaken in relation to the functioning of the internal economies, no such forecast can easily be made of the repercussions of the foreign trade The easiest way, therefore, seems to be the controlling of foreign trade It is also easier to do because foreign trade moves through far fewer and narrower channels, and from the administrative point of view it appears easier to control it It is not easy to

calculate what indirect effects a vigorous policy of this sort may lead to. For instance, it may mean enormous reduction in the standard of living of the people specially when the supply of home products is not quite elastic. It may also mean ultimately reduction in the exportable surplus, because after all exports are nothing but the counterpart of imports.

Several authorities on the theory of planning for the economic development of underdeveloped countries suggest that the control of foreign trade is imperative because the developmental needs lead in their turn to the recurrence of deficit balance of payments. The recurring deficit balance of payments which inevitably accompanies planning for economic development can be remedied by either increasing the exports or reducing the imports or both. It is always easy for the planning authorities to reduce the imports and the question of expanding the exports is inevitably left behind because of the irrational attitude on the part of most of the underdeveloped countries to substitute manufactured articles in place of the raw materials even at the early stage of economic development where it cannot easily be done.

But this tendency of economic planning leading to autarchy is not at all inevitable. Planning can be done in a way which might lead to expansion of trade rather than its contraction. Only it will be necessary to devote some little time and resources on research for finding out what should be the pattern of the growth of economy which may ultimately lead to the utilization of underdeveloped resources in such a way as to give a comparative cost advantage in the dynamic sense of the term. The developed countries on their part will have to adjust their pattern of production in a way that they leave the things in which they do not have the comparative advantage. Because of the great diversification of the economy it is highly probable that the United States may so adjust her pattern of production as to lead to greater and greater international division of labour.

It may, however, be noted that it is not possible for an underdeveloped country to have its own independent economic plan for development without any consideration of the others and still get the full benefits of planning. It is obvious that all underdeveloped countries cannot have comparative advantages in all lines of production which might be considered suitable for the development of such economies. First, there is the question

of natural endowment in which all economies are not equally rich which by itself suggests some sort of division of the lines of development. Moreover there is the question of the lack of demand within a country for the development of a certain industry, but this may not prove a bottleneck if the underdeveloped countries coordinate their plans and resources. The question of a potential demand for various commodities cannot be resolved within a single country as it is essentially a function of the purchasing power at the disposal of the people at large. It is obvious that the underdeveloped countries each one of them lack such a power. We shall have an occasion to discuss at length in the following chapter the relationship between the demand for a certain commodity and the prospects for its manufacture in an underdeveloped country. It will be found then that one of the most important reasons why foreign capitalists did not invest any great part of the capital for manufacturing commodities for internal consumption was that there was not enough of market for them. The underdeveloped countries, to start with, definitely lack internal markets which may induce the capitalists inside or from abroad to invest in large scale production of commodities. Yet if these countries coordinate with each other so that each one of them becomes the consumer of the products of the others it is possible for all of them to develop large scale production. They would be required to specialize only in those commodities in which they have or are likely to have comparative advantage in the long run.

Such coordination is not easy to bring about because the underdeveloped countries are normally jealous of each other and they do not like that any one country should progress leaving behind the other. The difficulty is aggravated because coordination among underdeveloped countries is not a natural process so far as the direction of trade is concerned. Countries with divergent climates could help themselves to each other's products. There are many commodities which can be manufactured with great advantage and on a large scale by the underdeveloped countries cooperating with one another. The Say's Law of Market, so to say will have a wider application among various countries of the underdeveloped region than within one country itself. The supply of one country would meet the demand in the other and vice versa.

Myrdal has suggested that this coordination between the underdeveloped countries is needed for a different reason as well. According to him, the underdeveloped countries although they have vast resources and human power simply hang around the major powers instead of evolving for themselves a mutually coordinated plan of development. Friendship is always between equals and it is only by developing together that the underdeveloped countries can be real partners with the developed countries. As such this inter-regional coordination would ultimately lead to an inter-national economy.

One very great difficulty, however, in a coordination of this sort arises from the reaction of those who have special interest in the established channels of trade. Such people are found within the country as well as outside it. Within the country there are those who have interests in becoming a party to the monopolistic situations which arise due to one particular channel of foreign trade being established for a long time. Then there are the outsiders who would not like any diversification in the channels of trade and may try to undercut the efforts of the underdeveloped countries at diversification and coordination between themselves. This does not, however, mean that all existing relations in international trade are necessarily bad. Many of them have definitely led to the good of the underdeveloped countries at least in the sense that there has been a breaking up of the feudal system leading to the start of a process of exchange economy. The exchange economy with its free enterprise is capable of giving rise to enormous progress and even such critics of the exchange economy as Karl Marx have never denied the great capability of such a system in giving rise to enormous material progress in many underdeveloped countries. Contact with the outsiders has been responsible for breaking up the rigidity of the feudal society. Colonialism is bad and it has led to some ruinous results so far as the underdeveloped countries are concerned. But the rising nationalism in its great enthusiasm for freedom from colonial rule sometimes leads to an irrational attitude and to a breaking up of all relations with the outsiders. Such an attitude is not a happy one specially when it is realized that the underdeveloped countries have much to gain from international trade.

The question whether a country should follow the policy of

autarchy or foreign trade depends on three simple calculations. In the first instance, it should be determined how much of the resources are required for the production of one unit of commodity at home. Secondly, it should be estimated how much of the other commodity which can be profitably exported could be produced with the same amount of resources if, alternatively, we chose to produce the commodities to be exported. Finally, a comparison should be made between the quantity which could be produced and the same quantity imported in case the alternative exportable commodity were produced at home and the commodity in question is imported from outside.

Sometimes the question of foreign trade *versus* autarchy is decided by making a narrow calculation of the monetary cost which is involved in the production of the commodity at home and the monetary price which is paid in case the commodity is imported. This is very fallacious because it neglects altogether the comparative advantages which can be secured by producing a commodity at home rather than importing it from abroad. For instance, this neglects a very important aspect that the production of the commodity at home might lead to the utilization of unused resources which in its turn might generate income and *via* super-multiplier to further expansion of the economy. If the unemployed resources include the unemployed labourers, then, there is a great satisfaction in reducing the human misery and degradation which inevitably go with unemployment. Then there is the infant industry argument which means that in the initial stages a commodity should be produced even when it costs more to give it a chance to compete favourably with others if it has some potential advantages. And finally, greater resourcefulness of the economy might mean greater strength to face difficulties which might arise due to financial stringency during periods of depression.

The Committee on Measures for Economic Development of Underdeveloped Countries has pointed out

Foreign Trade policy should be tested not by whether it is more or less autarchic, or creates more or less diversification, but by whether it leads to a situation where all things considered, nothing is produced at home which could in practice be bought abroad for a smaller quantity of resources, and

vice-versa, that nothing is bought abroad which could be produced at home for a smaller quantity of resources⁷

Strangely enough this statement in its ultimate analysis turns out to be a contradiction in itself, because the question of autarchy versus foreign trade can be decided only by considering whether the respective countries are producing the commodities according to their comparative advantages or not. If they produce in accordance with the principle of comparative advantage they are bound to be less autarchic. The second part of the statement of the Committee means obviously nothing except that every country is producing according to its comparative advantage and hence it is bound to be less autarchic. In a situation like this the first part of the statement, that is, "foreign trade policy should be tested not by whether it is more or less autarchic" becomes totally irrelevant.

As a matter of fact the question in dispute is whether foreign trade policy in its immediate effect leads to autarchy or not. The answer to this is that it surely does, and it leads to autarchy to become ultimately less autarchic. As we have pointed out earlier a temporary interference with the freedom of foreign trade leads ultimately to greater and more diversified trade by developing underdeveloped resources and by bringing dormant capabilities into active use. But this is in theory. In practice it will be necessary for the planning authority to proceed very cautiously so that nothing is done which appears beneficial in the short run, but may ultimately lead to a disadvantage.

In India before Independence the revenue aspect of the tariff was considered the main objective. The revenue from Customs used to make between forty and fifty per cent of the total revenue of the Central Government. After Independence the Government of India appointed a Fiscal Commission in 1949 to investigate the whole question of protection and assistance to the industrial development of the country. The Commission recommended special assistance to agriculture, and cottage and small-scale industries. Other important aims emphasized by the Commission were the maximum utilization of man-power and resources, increase in productivity, diversification of economy,

⁷ UN Department of Economic Affairs, *Measures for the Economic Development of Underdeveloped Countries* (New York, 1951), p. 57.

and the development of large-scale production. Having such aims, the Commission recommended that in the first instance defence and other strategic industries must be protected under all conditions, secondly, for the basic and key industries the tariff authority be required to decide the magnitude and the direction of protection and also to lay down the conditions for the grant of such protection, and, lastly, in regard to other industries protection should be granted to such industries where after considering cost of production and potential advantages it might be thought that within a reasonable period of time they would be in a position to compete successfully with the outsiders without governmental protection. In case it was considered that protection to certain industries was desirable from the point of view of national interest then it must be taken care that the cost of the protection should not be excessive.

It is thus obvious that the Commission was interested in the question of protection from the point of view of the development of economy rather than of revenue. On the recommendation of the Commission a permanent Tariff Commission has been created in 1952 which has been made responsible for looking into this question. The Tariff Commission has been provided with broad guidance for fulfilling the basic criteria needed for the protective policy of the country. For instance, the Tariff Commission has been well advised to take into consideration not simply the raw materials needed for the production of a commodity but also other economic advantages including a sizable domestic market and the potential export market. It has also been advised to consider the question of protection in case of an industry prior to its establishment only where large capital investments are necessary.

It is thus obvious that while the protective tariff policy of India has been mainly devised from the point of view of rapid economic development, the question of the expansion of foreign trade has not been left behind. The idea is to expand and diversify the economy in a manner leading to greater and greater expansion of foreign trade in which the Indian products can compete favourably with other products. There seems to be nothing incompatible between planning for economic development and planning for the expansion of foreign trade. Only the direction and composition of foreign trade are likely to change.

The Tariff Commission was also particular to point out that a very short period of protection was actually worse than no protection. The Commission was in general agreement with the following passage from Taussig: "The length of time to be allowed for the experiment should not be too brief. Ten years are not enough. Twenty years may be reasonably extended. Thirty years are not necessarily unreasonable." This shows that the Commission was interested in the long term economic development and had the long term perspective in mind. The dynamic theory of comparative cost which we have referred to must be considered in relation to the long term economic development.

CHAPTER III

FLOW OF INTERNATIONAL CAPITAL

WE have seen that although, in the process of economic development there are many factors which act and react upon each other and capital is formed in the process of economic development, yet as one single factor the amount of capital has been the most important variable in bringing about rapid economic development. Historically it may be noted that there has been no capitalist country which was in a position to develop at any rapid speed with the amount of capital accumulated within it, and that a good deal of the earlier industrial development in practically all of them has been due to the influx of foreign capital. For instance, it has been demonstrated by competent economic historians that the process of industrial revolution in England was accelerated by some of the immigrants who brought with them the capital and technology. Once UK was fairly well developed, a very large amount of capital was being exported for about half a century, beginning in 1825, to different countries in which European countries had the major share. Later on, some of the European countries specially France and Germany along with the UK exported capital to the United States for its economic development. Sometimes the extent of borrowing from abroad increased so alarmingly that it was not possible for the borrower to service the past loans from its own surplus so that it had to borrow even for the servicing of loans and for repayment of the past capital. For instance, during the years 1874 and 1897, the United States was borrowing to such an extent that its own trade surplus was insufficient to service the debt and it became necessary to make use of some of the foreign exchange available out of the newer loans for the payment of interest and dividends on old capital. A similar situation was faced by Canada during the period of its rapid industrial growth from 1900 to 1913 and from 1920 to 1929 when she had to service the past loans by incurring fresh ones.

It is thus obvious that the internal accumulation of capital can hardly be sufficient to bring about a rapid economic develop-

ment and that foreign capital has always been responsible in accelerating the speed of economic development. It is admitted that the USSR was in a position to bring about rapid economic development without any inflow of capital, even so there had been a sustained inflow of capital between 1881 and 1913 specially from France which had established the base on which the industrial revolution could stand. Moreover, the exceedingly low level of living of the masses, which was enforced by the Central Planning Authority in the Soviet Union, cannot easily be practised in countries with different social and institutional conditions.

The reason why capital has always flowed from the more developed to the less developed (and developing) countries has been found by Adam Smith and Malthus in the secular tendency of falling of the rate of profit which they considered was the result of over-abundance of capital in the developed countries. In this classical tradition Marx developed his theory of the falling tendency of the rate of profit on the basis of the changing organic composition of capital. According to his thesis, capitalist development was associated with rising constant composition of capital with the result that surplus value, which was due only to the variable capital, diminished in great magnitude. And since the rate of profit could be found by dividing the surplus value by the total capital there has been a continuous tendency of fall in the rate of profit. Moreover, with the diminution in the variable capital the total employment diminished resulting in the fall of income of the labouring masses. This in its turn led to under-consumption and therefore added another impulse to the fall in the rate of profit. The capital was therefore considered to be compelled to flow out of the more advanced to the less advanced (but advancing) countries where it could earn a high rate of profit. Recently under the impact of Keynesian economics, capital exports have come to be associated with an increase in effective demand and employment in the capital exporting countries. Thus Keynesian economics has given a sort of support to the Marxian thesis that the capital from the advanced countries cannot but flow out to maintain a high rate of profit and to keep the capitalist system intact.

If there were to be a compulsion of this sort, it would be beneficial to all concerned and there is nothing bad about it. But

the fact is that this sort of compulsion is not obvious at least from what has happened in practice in regard to the flow of foreign capital. The countries which want to import capital have even now to provide incentives and create favourable conditions so that capital might be available to them. Keynesian economics while it provided the explanation for the existence of involuntary unemployment in the lack of effective demand has also provided the policies with the help of which the developed countries can maintain a high level of employment. The real cause for foreign investment is not because it is compelled to flow out but because it is fundamentally a means of improving the distribution and the use of world's productive resources. The traditional theory of factor proportions is that wherever capital is available in greater quantity its marginal productivity is comparatively lower than in the countries where capital is scarce and therefore, left to itself, capital will flow from the countries where it is relatively abundant to the ones where it is scarce. According to this theory, capital from the advanced capitalist countries should flow to the underdeveloped countries. But this has not happened. Table 1 giving the geographical distribution of the US direct capital between 1929 and 1953 shows that slightly over half of the total capital of the United States went to Canada.

TABLE 1
GEOGRAPHICAL DISTRIBUTION OF US DIRECT PRIVATE
INVESTMENT 1929-53

	<i>In millions of dollars</i>		<i>Share in percentage</i>	
	1929	1953	1929	1953
Total US direct private investment	75	168	100.0	100.0
I Developed countries	36	82	48.0	50.4
(a) Canada	20	52	27.0	32.0
(b) UK	05	11	7.0	7.0
(c) Others	11	19	14.0	12.0
II Underdeveloped countries	39	81	52.0	49.6
(a) Latin America	35	60	47.0	37.0
(b) Middle East	001	07	0.1	4.0
(c) Colonies of West European countries	02	06	3.0	4.0
(d) Others	02	08	3.0	5.0

Table 1 also shows that comparatively a large proportion of the US investment went to Latin America rather than to Asian countries. The fact that the population of the underdeveloped areas is as much as 1173 million compared to the total population of the developed world of 324 million shows that the flow of capital has not been according to the traditional theory of factor proportions.

Moreover, whatever little capital has gone to the underdeveloped countries, a greater proportion has been used for agriculture and in extractive industries. In contrast, the capital flowing to the developed countries has been mostly employed in the manufactures. Table 2 based on the distribution of capital between the developed and the underdeveloped countries according to the distribution in various sectors of the economy is revealing in that the direct investment in the underdeveloped areas has gone mostly into the fields of plantations, oil fields etc.

TABLE 2
DISTRIBUTION BY SECTORS OF THE U.S. FOREIGN
INVESTMENTS 1929-53

	<i>In billions of dollars</i>		<i>Share in percentage</i>	
	1929	1953	1929	1953
I Developed Countries	3.6	8.2	100	100
(a) Agriculture and extractive industries	0.8	2.5	22	30
(b) Manufactures	1.5	3.9	42	48
(c) Others	1.3	1.8	36	22
II Underdeveloped countries	3.9	8.2	100	100
(a) Agriculture and extractive industries	2.4	5.1	60	62
(b) Manufactures	0.3	1.4	8	17
(c) Others	1.2	1.6	32	21

This does not mean that the traditional theory of factor proportion is altogether wrong. As we have already noted, in the underdeveloped countries there is a great difference between the social marginal net product and the individual marginal net product. It follows that, if somehow, an investment is made in the social overheads and the foundation for capitalistic develop-

ment is laid, individual capitalists will be in a position to start innovations and the capitalists abroad would like to send their capital to the underdeveloped countries in greater quantities and for manufacturing projects. But it is not possible for an individual capitalist to lay down such a foundation and therefore the flow of capital is bound to be meagre.

There might have been some political reasons also, but one of the most important economic reasons for the fact that foreign capital in underdeveloped areas was generally invested in the extractive industries is that there has not been a sufficiently wide market for the products of the manufacturing industries. Moreover, during the nineteenth and the early part of the twentieth century, there were vigorously expanding markets for primary products in the industrially advanced countries of the world. The result was that private capitalists who were motivated by individual profits thought it more profitable to invest in extractive industries and produce raw materials for the world's expanding markets.

There are some authorities who believe that direct investment in the underdeveloped countries has been made with the specific objective of sheer exploitation. It has been suggested that foreign capital in the underdeveloped countries was foreign only in the geographical sense of the term, otherwise it has been a part of the machinery of the capitalists to exploit wherever it was easier for them to do. Myrdal has suggested that the foreign capital which flowed to the underdeveloped countries was used for purposes of building up economic enclaves meant for exploiting the countries. Such economic enclaves, he proceeds to argue, were never integrated into the economic system and consequently they never brought about any advantage to them. He therefore advises the underdeveloped countries to do away with the enclaves and immediately nationalize such enclaves as are in existence.

From the narrow nationalistic point of view such an attitude might be considered reasonable, but hardly so on economic considerations. We shall have occasion for going into further details about the advantages which can be derived from the inflow of direct investment, but for the moment it is necessary to point out that contact with foreigners, whatever its political implications, has always been responsible for the breaking up of the feudal society and increasing the spirit for innovations. The

fact that foreign investments could not penetrate into the interior of the underdeveloped countries is due to the prevalence of the pre-capitalistic feudal society and the extreme poverty of the masses. In many of the underdeveloped countries, for instance in India, foreign capital has been associated in the minds of the people with colonial rule from which the people wanted to free themselves. In their zeal, therefore, they might want independence in all respects, even in cultural and economic relations. But that is hardly a rational attitude at present. Our Prime Minister in a speech on 6 April 1949 about the industrial policy in regard to the participation of foreign capital has aptly pointed out

"The stress on the need to regulate, in the national interest, the scope and manner of foreign capital arose from past association of foreign capital and control with foreign domination of the economy of the country. But circumstances today are quite different. The object of our regulation should therefore be the utilization of foreign capital in a manner most advantageous to the country." He went on to add "Indian capital needs to be supplemented by foreign capital not only because our national savings will not be enough for the rapid development of the country on the scale we wish but also because in many cases scientific, technical and industrial knowledge, and capital equipment can best be secured along with foreign capital."

It is therefore obvious that foreign capital as such can be discarded only at the cost of great harm to the nation. But private capitalists can be expected to invest primarily for the satisfaction of internal wants of the people only if the basis for industrial development is laid down which however cannot be expected of them. The difficulty can be illustrated by means of a single example. In developed countries where there are many capitalists it is possible for each one of them to spend quite a handsome amount of money on the training of people for managerial positions. If the people whom they have trained do not stay with them there will not be any great harm to them because likewise there would be other capitalists who might have trained some other people and whose trainees might shift on to these capitalists. In this way the change over of the managers and the technicians from one firm to the other will cancel each other and no individual capitalist would be under a net loss. This sort of situation does not exist in an underdeveloped country and hence

no individual capitalist would be willing to spend any great amount on the training of personnel. Moreover, the absence of such overheads as power plants, railways, roadways, etc. would act as a great disincentive for the capitalists to invest. Therefore while it is desirable to encourage private foreign capital, it is also necessary to incur the initial expenditure in overheads and social, general and technical education for the industrial base and provide the incentives to the private capitalists.

The expenditure to be incurred on the facilities to provide the developmental base can be classified into two parts—the one which can be commercially considered productive in the sense that in the long period it can generate income out of which the total cost can be recovered and the other which is highly productive but cannot be considered commercially advantageous. The first category includes the expenditure on public utilities, railroads, highways, electric power stations, irrigation, port facilities and the like. The second part includes expenditure on public health, education and training. The second category cannot be considered profitable unless it is realized that the human capital is of enormous importance in the process of economic development of a country. Most of the underdeveloped countries do not have the money which is required for this purpose, nor can they borrow it. The only way out of this difficulty is that grants-in-aid be given by the Governments of the developed countries to those of the underdeveloped. It is, however, of great importance that these grants-in-aid be kept strictly separate from loans. It is unfortunate that the United States, because of its past sad experience in foreign lending, has begun lumping together grants-in-aid and loans given to the underdeveloped countries under the head of American Aid. This is very demoralizing specially for the underdeveloped countries which become carefree after receiving the so called aid and do not apply strictly commercial principles for the best utilization of the loans given to them because psychologically they consider these also as grants. We have noted earlier that the external fund can add to the productive capacity only if it is combined with the domestic act of savings. It is very likely that the loans when they are given under the aid may lead to the relaxation of domestic efforts at saving. Even when the loan is earmarked for a specific purpose such a confusion between business principles may lead to an

unbusinesslike extravagance on the part of the underdeveloped countries

It is also very desirable that these grants be given by international agencies rather than by individual governments. The Committee for Measures for Economic Development of the Underdeveloped Countries has recommended that a UN body called the International Development Authority be established and be given power to make grants to the governments of underdeveloped countries for purposes of research and education, public health programmes, subsidization of medium and short term farm credit, and improvements of rural public works¹

There are some specific reasons why these grants should be given by international agencies rather than by individual governments. First, when grants are made by individual countries they have an association of some political element. Viner has aptly pointed out that government grants or loans cannot be very important except for political and strategic considerations. But strategic considerations are not necessarily the best economic considerations. Very often grants based on strategic considerations might go to the least efficient governments and might not lead to the economic welfare of the people. Only by insulating the ultimate receivers of financial aid from the contributors through the formation of an international agency will it be possible to remove the political element from the giving of grants. Secondly, the grants at present are given only by big countries like the United States, while it is desirable for all the developed countries to contribute something for the welfare of the underdeveloped countries. There are some smaller developed countries such as Norway and Sweden which, we are told, would like to contribute to the international agency without the burden of setting up a separate organization for administering the grants. And finally, it is only by this measure that the aid coming forth would become of some reasonable magnitude. Aids which are given in small magnitudes are likely to create frustration and disappointment rather than encouragement. Myrdal has quoted Paul Streeten who wrote to him, "Sometimes I think it is not so much the absolute level of poverty that makes for Communism as, having become somewhat better off, not growing better off

¹ Cf. UN Department of Economic Affairs, *Measures for the Economic Development of Underdeveloped Countries*, p. 85

fast enough, particularly if the initial improvement is accompanied by contact with people who are much better off. A little American aid may be a greater force for Communism than none which, obviously is no argument against aid." Myrdal has added to it, "But it may be an argument for a truly international aid given on a sufficient scale."²

The fact, however, is that it is quite difficult to organize a purely international agency. USA is so awkwardly big that some people fear that it is likely to dominate the international organization formed for the purpose. But an international agency which might maintain independence and objectivity is not impossible to form. The example of the IBRD is at hand. It has been able to maintain a considerable degree of independence and objectivity and a similar organization can be formed.

Grants, however, can be made only for purposes of general education, public health, etc. which increase human efficiency and cannot be considered purely from a commercial point of view. But, as we have noted, the wide difference between the social marginal productivity and individual marginal productivity in the underdeveloped countries can be narrowed down by investing considerable sums of capital on such overheads as power plants, development of basic industries and means of communication and transport. These expenditures lie halfway between the purely humanitarian considerations and the purely commercial considerations in that while they are not commercially profitable to individual entrepreneurs, they can become a source of good returns over a period of time. Such projects can be undertaken usefully by the governments of the underdeveloped countries by getting loans from abroad.

Before the Great Depression there used to be an international capital market in which both governments and private entrepreneurs could easily float loans, but the disintegration of such a market which began in mid 1928 affected the borrowing of every one. During the period of declining business activity and prices, the real cost of loans increased considerably because of the fixed rates of servicing. The balance of payments difficulties which occurred in most of the borrowing countries increased the risks to the lender and also complicated the problems of repayment. The underdeveloped countries, however, were under

² G. Myrdal *An International Economy*, pp. 135-6.

special difficulties because in the international market loans were economical to the large and the better known borrowers

It has therefore become necessary for the underdeveloped countries to borrow either from foreign governments or international agencies. For the underdeveloped countries it is more preferable to borrow from international agencies because they have the least political implications (if any), but as we shall see these agencies cannot fulfil the primary needs of these countries and therefore they have to have recourse to borrowing from foreign governments. Foreign governments which can lend to the underdeveloped countries have established institutions through which the loans are disbursed. By far the largest institution for lending to the underdeveloped countries so far is the Export Import Bank of Washington. The Bank was established by the United States in 1934 as a government institution to finance transactions and projects with foreign countries. Its main purpose is to lend for projects which would directly or indirectly promote the United States foreign trade. It has the commercial attitude and the request has to be just from the point of view of capabilities of dollar earnings or savings from which the servicing and repayment can be made. Its loans have carried usually a rate of interest between $3\frac{1}{2}$ and 6 per cent and the loans are advanced for a period up to twenty years.

The Export Import Bank's activities follow different patterns. They make exporter-credit directly to a government or its agents for purposes of importation of equipment and services from the United States, and manufacturers who themselves participate in the provision of credit. Then they advance direct loans for financing projects for which the Bank provides capital and operational techniques. Finally there are ordinary loans which are given for the purchase of US equipment in which neither the Bank nor the private manufacturers directly participate.

Similar other institutions have been established by the UK, Japan and others. But it is obvious that there are certain great disadvantages from the point of view of the underdeveloped countries to borrow from such institutions. First, such loans are "tied" in the sense that with the help of these loans purchases can be made only in the countries concerned. This means in certain cases, specially in the case of loans from Export Import

Bank, the underdeveloped countries have got to pay more in terms of cost than if they could use the credit in other markets. The restrictions on the free convertibility of the currency also make it imperative that the loans are used in such a way that the dollar earnings might increase. This enforces bilateralism and as such the underdeveloped countries are not allowed to reap the benefits of the multilateral trading system. Moreover, there are many countries which produce excellent equipment useful to the underdeveloped countries but they do not have sufficient credit to give to the underdeveloped countries. In this way, the underdeveloped countries cannot get the advantage of such equipment. If such institutions are internationalized as a step to the formation of the international capital market it can greatly lead to the advantage of the underdeveloped countries and the expansion of world trade.

Because of the disadvantages associated with the loans from governmental institutions the underdeveloped countries have a tendency to approach the IBRD for loans. As the International Bank has pointed out in its memorandum on financing economic development submitted to the UN secretarial investigation on Methods of Financing Development in Underdeveloped Countries, "One of the basic purposes of the International Bank for Reconstruction and Development as stated in its articles of agreement, is the encouragement of the development of productive facilities and resources in less developed countries."³ The Bank therefore has been continuously taking interest in the development of underdeveloped countries. It initially started its lending for the reconstruction of Europe. Since 1952, the great emphasis has been on lending to underdeveloped countries. South East Asia has considerably increased its borrowings, and India has emerged as the largest of the Bank's debtors over the past five years. The Bank has also accelerated its lending to Latin America, Asia, and Africa.

Being a development bank its lending has necessarily been on the long-term basis and it has also gained experience in matters of technical assistance insofar as it is concerned with formulating comprehensive economic development programmes, administrative skill and engineering capabilities. The Bank

³UN Department of Economic Affairs *Methods of Financing Economic Development in Underdeveloped Countries* (Lake Success, NY 1949), p. 89.

advances loans for some specific projects but it insists that the project must be considered as part of the organic whole of the economy

As an international institution the Bank has been primarily concerned with providing stimulation to foreign investment by mobilizing capital from the capital exporting countries and lending it to the capital importing countries. The greater proportion of the capital in the past has come from the USA but it is now coming increasingly from other countries as well

The Bank has to see to it that it advances credit only when no other source of finance is available. There are certain kinds of projects in the underdeveloped countries, for instance, transportation and communication, power, irrigation, land reclamation and others that are absolutely essential for the development of the economy. Yet private capital would not be forthcoming for the development of such projects as the amount of capital required for them is enormous and returns accrue after a long period. Development of these projects, as the Bank has pointed out in its third annual report, is not only essential for a well balanced development of the economy but is also a pre-condition for the investment of private foreign capital. Since private capital for such projects would not be forthcoming, the Bank feels that this is the type of development that is most apt to acquire assistance from the Bank either in the form of direct loans or of guarantees.

Since the Bank's attitude towards lending is that no country should borrow more than it can usefully utilize and repay, in the earlier years the Bank was very sceptical about advancing loans in the absence of comprehensive plans by the underdeveloped countries. In the fourth annual report it suggests that the principal limitation upon the Bank financing the development programme has not been the lack of money but the lack of well prepared and well planned projects ready for immediate execution. It was felt that "In the best of circumstances development is not something which can be sketched on the drawing board and then translated into reality simply through the provision of finance."

With the beginning of comprehensive planning in most of the underdeveloped countries however, the Bank, has begun advancing loans for their projects. But before the loan is made the

Bank examines the principal plans to see whether any improvements in the early specification can be made. This preparatory study is sometimes very useful, for instance, the exchange of ideas between the Bank and the Indian Iron and Steel Company resulted in the conclusion that the addition of a new coke oven to the Company's construction programme would make it possible and useful to retain and modernize two blast furnaces that otherwise would have been abandoned.

The policy of the Bank's lending and its limitation to loans is directly governed by its character. The Bank can normally lend only against specific projects and it would limit its financing only to the extent of the foreign exchange component. The first condition requires that the borrowing country must provide justification for the project and accept the condition of the Bank's supervision right through its completion. The second condition is that the Bank would not give more than what was needed for the import of capital equipment and technical services. The people of the underdeveloped countries sometimes irrationally take the first condition to be an interference from outside although it is to their advantage that a competent authority like the Bank should be interested in the general supervision of the project. The second condition is rightly criticized by some competent authorities. For instance, the Committee for the Measures for Economic Development of the Underdeveloped Countries pointed out

the IBRD attaches excessive importance to the foreign currency aspect of the development. In our judgement, what is more important is to build up the capacity to produce goods and services. The Bank should start from this point, rather than a measurement of the foreign currency needs. And if development succeeds the transfer problem of meeting the debt charges should take care of itself. At present, the Bank puts the cart of foreign exchange difficulties before the horse of economic development.⁴

Since the Bank already takes into consideration the credit-worthiness of the borrower while approving the project for development, a second condition, namely, of the foreign

⁴ *Ibid*, p 83

exchange component is unnecessary. The Bank's insistence on this condition is based on the argument that the internal savings should form at least about one half of the total cost of the project. It has often been pointed out that the external capital should be considered only as a supplement to the internal efforts at savings, and that a major part of finance should come from the internal resources. Moreover, there is the administrative convenience in that the Bank can easily supervise the disbursement of loans and release foreign exchange only against approved expenditures. The Bank however has not rigorously held to the position that it should supply no local currency. In the fifth annual report, it has laid down three conditions for the giving of loans in local currencies. They are, (a) if the project to be financed is of such economic urgency that the country's ability to undertake foreign borrowing would be better utilized in financing the project rather than in financing the foreign exchange cost of the alternative project, (b) if the local currency cost of the project cannot possibly come out of the internal resources, and (c) if it is apparent that unless the foreign exchange is available for purposes of importing the consumer's goods or new materials, the local currency expenditures involved in the project would lead to inflationary pressures.

The rate of interest charged by the Bank is the same irrespective of the differing creditworthiness of different countries. The rate of interest charged is related to the one which the Bank would have to pay if it were to make a bond issue of similar maturity in Wall Street. To this are added $\frac{1}{4}$ per cent administrative charges and one per cent commission charges. Thus the rate of interest charged has been between 4 and 6 per cent. As a matter of fact, this charge of one per cent commission is rather excessive in view of the fact that the underdeveloped countries cannot afford to pay a high rate of interest, specially when they have to have loans from the IBRD to be spent on overheads whose returns are available only after a long period and are rather uncertain. The one per cent commission is justified by the Bank on the ground that there is a fear of default in the case of many underdeveloped countries and that there must be a liquid reserve against that. Strict commercial policy demands that the Bank should charge higher rate from those countries where the fear of default is great and creditworthy

countries such as India should not suffer on account of that

It is however to be noted that so far the Bank's policy has been to advance loans for purposes of building up the overheads and it has not lent to the development of other industries. This is due to the fact that government guarantee is needed for the loans advanced by the Bank to private firms which neither the firms like, as it means government's interference into their affairs, nor the governments are prepared to undertake because they do not want to increase their credit responsibilities in regard to private business. Moreover, the Bank is not willing to finance manufacturing industries under government ownership. This is because the Bank realizes that although expenditure on overheads is necessary for the development of any industries in the country yet it is not necessary for the governments of the underdeveloped countries to have all the industries under their control. There is a great force inherent in the decentralized industrial system to generate economic development, yet, the strict attitude of the Bank in not providing finance to public enterprise of any sort can hardly be justified. Cairn Cross aptly points out

A European observer, living in a mixed economy, cannot altogether share the ideological hostility of the Bank to public enterprise in manufacturing industry, although he may recognize its imperfections, and the Finance Minister—and still more the Central Bank—of an underdeveloped country may see inconveniences in relying too exclusively on private foreign investment for the development of new industries. These are large matters. The Bank is much too intelligent to see the issues in black and white, and its bias rests as heavily on experience and actual conduct of industry in underdeveloped countries as on the economic philosophy natural to Washington.⁵

Recently it has been realized that the criticisms which are levelled against the lending operations of the IBRD and the IFC, regarding the high rate of interest, the repayment in dollars and the Bank's policy of not lending to industrial enterprises in the public sector, are justified to a great extent. The

⁵ Alec Cairn Cross, "The International Bank for Reconstruction and Development", *Essays in International Finance*, No. 33, March 1959, p. 22

United States therefore has proposed in the last Bank Fund meeting held in Washington towards the end of September 1959 the establishment of the International Development Association to be affiliated to the IBRD to fill the important need of the development of underdeveloped countries. By providing loans repayable in local currency and at the rate of interest of nearly $2\frac{1}{2}$ per cent (as against that between 4 and 6 per cent charged by the Bank) it is likely to accelerate the economic development of the underdeveloped countries. One feature which will be most interesting to the Governments of the underdeveloped countries is that the Association should also be empowered to lend to projects in the public sector.

Throughout its operation it has been the Bank's policy to advance loans only in the case of projects for which loans cannot be obtained from private sources on reasonable terms and where there are reasonable prospects for the repayment of the loans. The Bank also realizes that the flow of private capital would not be forthcoming unless a lot of money is spent on overheads for which the Bank is always prepared to assist provided at least an equal share of capital is forthcoming from domestic savings. It has specifically been pointed out in the fourth annual report that in the judgement of the Bank foreign financing should be derived mainly from private sources, because in the long run it is only the sustained flow of private capital which can help the development of underdeveloped economies to any significant extent. In particular it is plainly desirable that direct private investments on mutually fair terms be the major source of foreign capital for development in order to avoid an undue burden of fixed charges and more important to take advantage of the essential technical and managerial skills which are normally associated with such investments and often are not obtainable in any other way.⁶

The Bank has also been providing facilities for the flow of private capital. One way of such assistance has been that it has helped to set up development banks for the purpose of assisting industrialization. The Bank prefers that such institutions when they are established must be run either as private corporations or with representatives drawn from private industries. For instance, it has encouraged the establishment of the Industrial Credit and

Investment Corporation of India Ltd by contributing capital worth \$ 10 million in various currencies for the purchase of imported material, equipment and services. This is a privately sponsored institution for purposes of assisting in the creation, expansion and modernization of private enterprise, encouraging the participation of internal and external private capital and also private ownership of industrial investment. The Government of India has also agreed to advance a sum of Rs. 75 crores free of interest. We shall have occasion to discuss the functioning of this Corporation in our discussion on Indian economic development. At present, it can be mentioned that the IBRD has made no absolute rule that it would not provide assistance to the developmental banks owned by governments provided these government owned institutions encouraged free enterprise.

A very important institution established by the Bank as an affiliate to it for purposes of stepping up the flow of private capital to the underdeveloped countries is the International Finance Corporation set up in July 1956. This Corporation invests in productive private undertakings in the form of debenture capital in association with private entrepreneurs. The main aim of the Corporation is to stimulate and help create conditions which will make internal and external private capital flow into productive enterprises. The investments to be made by the Corporation will be without any governmental guarantee. This facilitates to a great extent private investment because unlike the loans of the IBRD private investors do not have to look for assistance from the government for the giving of guarantees which in most cases they are reluctant to provide. Although the Corporation can invest in any kind of private enterprise for instance, agriculture, financial or commercial undertakings, yet its main emphasis is on the development of private industry. One very important thing to be noted is that the Corporation is not exempted from the foreign exchange regulation in matters of transfer of earnings and the repayment of the principal. In this way the Corporation has been treated as private investors in general.

During the first two years of its operation the Corporation has not made any great amount of investment. But there is a possibility that its activities would be accelerated because it can make loans in local currencies and therefore free the borrowers from the difficulty of repayment due to the shortage of dollars.

The Bank has also facilitated the flow of private capital by having a close relationship between the Development Loan Fund of the United States Government and its operations. The Development Loan Fund is designed to make loans repayable in the local currency of the borrower. These loans have been made to projects which are being partially financed by the Bank. Thus the Bank by thoroughly investigating the project facilitates the advancing of loans by the Development Loan Fund, and the Development Loan Fund gives the borrowing countries the advantage of increasing the foreign exchange they can borrow for development without increasing the debt service burden on their future balance of payments.

On the whole, therefore, it is quite clear that although grants and loans from governmental and international institutions can lay the foundation for the development of an underdeveloped economy they cannot by themselves lead to the growth of economy as such. It has been aptly pointed out that the underdeveloped countries will have to make a great effort in mobilizing the internal resources for their development. Foreign capital, however, if made available under appropriate conditions can accelerate the process of economic development. The grants and loans from inter governmental and international agencies provide conditions under which the flow of internal as well as external capital for productive enterprises can easily come forth. The external capital can be available in two forms—either as direct investment or in the form of portfolio capital without any participation in the control of business.

The direct investment capital has got certain advantages. It is imbued by profit motive and therefore it is likely to be productively employed. By re-investing its capital it can expand considerably the industry in which it is employed. It not only increases capital and enterprise but also brings with it modern technology and efficient managerial skill. On the whole it can be considered to be a reliable index of the economic prospect of the local economy. One thing which is very certain about this type of capital is that it creates real addition to the productive capacity which may not take place in the case of loans. It is because one cannot be quite sure, when the loans are available from the external sources, that the internal efforts at increasing the savings would not be relaxed. From the point of view of business fluctua-

tions direct investment has got the advantage that it does not impose any rigid conditions about interest and amortization and as such does not create foreign exchange difficulties specially during periods of depression. The spread of capitalist conditions initiated by foreign capital leads to the development of internal talents of managerial skill and enterprise. They induce the people, so to say, to become more enterprising.

In spite of all these advantages the underdeveloped countries do not look favourably towards this type of investment. Sometimes their attitude is quite rational. In the past, direct private foreign investment in the underdeveloped countries had often been associated with the spirit of colonialism and imperialism. Further, in the nineteenth century because of the poverty of local consumers and also because of the expanding markets for the primary products most of the direct foreign investment had gone into the extractive industries leading to undue exploitation of resources. Although there are certain benefits associated with it specially in that foreign investment was responsible for breaking up the feudal society it could not develop the spirit of capitalist enterprise.

It is also possible that private foreign investment may not fulfil the requirements of the economy and lead to a lopsided economic development which may even become an impediment for the further progress of the economy. The greatest difficulty about such investment is that it would not be forthcoming unless the return is quite high. It is well known that in the United States investment in good industrial equities brings forth a rate of profit of at least 6 per cent. If the underdeveloped countries want to attract capital they will have to yield a return of at least 10 per cent.

It is therefore, obvious that although direct foreign investment leads to certain advantages it cannot be of any great use unless it is regulated in the national interests of the underdeveloped countries. The object of the regulation, however, should be the utilization of foreign capital in a manner which is advantageous to both the country and the investors.

The difficulties which are created against the internal capitalists are likely to create very unfavourable conditions for the outsiders whose capital is liable to greater risks. According to a report by a League of Nations group of experts in 1945, the chief

obstacles to the inflow of direct private foreign investment are: (a) lack of equality in access to law and fear of arbitrary behaviour by the administrative authority, (b) double taxation, (c) fear of discriminatory taxation, (d) compulsory reinvestment of profits, (e) compulsory participation with domestic capital, (f) inflexible provision regarding the employment of foreign personnel, (g) restriction on the ownership of land, mineral deposits, etc., (h) restriction on transfer abroad of profits, and (i) lack of assurance of appropriate compensation in the event of nationalization and expropriation.⁷

It may be noted that the last two obstacles can be said to be the fundamental ones. If direct foreign investment is to participate in the process of economic development of an underdeveloped country it must be assured that it will have the facility of taking away at least a reasonable part of profits to its country and that in the event of nationalization fair compensation would be paid to them. The capital importing countries are required to give guarantees for these purposes. However, the ability to fulfil the commitments depends on the future balance of payments position. In the case of equity capital, since its return varies according to the variations in business conditions it is said that it avoids the balance of payments difficulty. But that in its turn involves a higher rate of return which means a great cost to the underdeveloped country.

Sometimes it is suggested that the underdeveloped countries should give only partial guarantees and that the governments of the capital exporting countries should provide the rest of it. This pattern was followed in the case of European Recovery Programme in which the US Government provided the guarantee. But this means a greater control and supervision of the economic affairs of the underdeveloped countries by the governments of the capital exporting countries. The underdeveloped countries with the recent memories of colonialism and imperialism would not like this sort of interference.

The Prime Minister of India in his policy announcement on 6 April 1949 about the participation of foreign capital in Indian business enterprise has given an assurance to the foreign investors that the Indian Government would put no hindrance to

their earning profits in India and transferring them to their countries within the possibility of the availability of foreign exchange, and whenever a foreign enterprise is nationalized compensation on a fair basis would be paid. More specifically he said

In the first place I would like to state that Government would expect all undertakings, Indian or foreign, to conform to the general requirement of their industrial policy. As regards existing foreign interests, Government do not intend to place any restrictions or impose any conditions which are not applicable to similar Indian enterprise. Government would also so frame their policy as to enable further foreign capital to be invested in India on terms and conditions that are mutually advantageous.

Secondly, foreign interest would be permitted to earn profits, subject only to regulations common to all. We do not foresee any difficulty in continuing the existing facilities for remittance of profits, and Government have no intention to place any restriction on withdrawal of foreign capital investments, but remittance facilities would naturally depend on foreign exchange considerations. If however any foreign concerns come to be compulsorily acquired, Government would provide reasonable facilities for the remittance of proceeds.

Thirdly, if and when foreign enterprises are compulsorily acquired, compensation will be paid on a fair and equitable basis as already announced in the Government's Statement of Policy.

In the industrial policy announced earlier in 1948, however, it was mentioned that effective control of the Indian enterprise would be kept in the hands of Indians. This means that whereas foreign investors would be encouraged to participate in Indian enterprise and would also be allowed to keep control for a limited period of time the policy would be to eventually transfer the controlling power to Indians. The foreigners would also be allowed to have foreign personnel when Indians with the requisite skill are not available but they would be required to train Indians as quickly as possible.

One interesting feature of foreign enterprise is that they invoke

internal capitalists to combine with them. In India where private capital has been notorious for its shyness it has been forthcoming in great quantity specially in partnership with foreign investors.

In order to offset the dangers of direct foreign investment new forms of organizations have recently come into being in which foreign investors, local governments and sometimes local investors participate together. The idea of such a joint venture is that the technical knowledge and skill which are associated with private foreign investment be transferred as soon as possible to the local people and at the same time to keep the effective control of the enterprise in the hands of the local government and entrepreneurs. In India, for instance, Government have entered into partnership with foreign private capital in several manufacturing undertakings such as Iron and Steel Plants, Fertilizer Plants and the Heavy Electrical Equipment Factory. Sometimes it is suggested that this form of organization is not without its disadvantages in that too much participation of the local personnel at the early stages of industrialization may increase the cost and that participation of the Government may involve some non-economic difficulties. But these disadvantages seem to be insignificant as compared to the enormous benefits which can be derived from the sound development of such organizations.

The other form of private foreign capital is portfolio investment. It is more acceptable to the underdeveloped countries because of its lower cost in terms of the rate of interest and greater control by the local entrepreneurs. But it has got a great disadvantage in that it is not accompanied by the technology and managerial skill and as such might involve higher real costs in the earlier stages of economic development when there is a great lack of technology and managerial skill.

On the other hand it means greater freedom in matters of economic activities and also greater responsibilities to do things in our own ways. Both direct and portfolio investments have their advantages and disadvantages, and it is a matter of choice for an underdeveloped country how much of what type of capital it will like to have.

It will not be out of place to discuss briefly the Point Four Programme before we close this chapter. This programme of international cooperation for providing technical assistance

for economic development to the underdeveloped areas came into existence with President Truman's inaugural address on 20 January 1949. Taken in parts it runs as follows

we must embark on a bold new programme for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas

The United States is pre-eminent among nations in the development of industrial and scientific techniques. I believe that we should make available to peace loving peoples the benefits of our store of technical knowledge in order to help them realize their aspirations for a better life. And in co-operation with other nations, we should foster capital investments in areas needing development.*

The words "bold new programme" had led many underdeveloped countries to expect too much from the USA by way of technical assistance in the form of grants. And when an appropriation of only 34.9 million was made for the first year's spending, many of them felt a setback. In fact the President in his speech had made it clear that the material resources which could be made available for the technical assistance of other peoples were limited. In the elaboration of the programme it was made very clear that the Point Four Programme would help the underdeveloped countries to help themselves to progress. The cost of the programme would be a modest one and it would meet only the salaries of the technicians, students and expert staff sent to the beneficiary countries. The effect of the efforts of such technical staff would be multiplied many times as they stimulated productive activity on the part of the underdeveloped countries. It was mentioned very clearly that the programme would not involve any transfers of commodities or financing the construction of projects.

The Point Four Programme in its broad perspective was to be an effort on international cooperative basis to elevate the conditions of underdeveloped areas, and the United States was to be one of the participants. To put it in President Truman's words,

* Committee on Foreign Affairs *Point Four Programme International Technical Cooperation Act of 1949* (Washington 1949) p. 21

"We invite other countries to pool their technological resources in this undertaking. Their contributions will be warmly welcomed. This should be a cooperative enterprise in which all nations work together through the United Nations and its specialized agencies wherever practicable. It must be a world-wide effort for achievement of peace, plenty and freedom."⁹

Accordingly the United States Government asked the Economic and Social Council of the United Nations to consider what the UN and its specialized agencies could do in this respect. The UN drew up schemes to be implemented through its agencies for development of industry, labour, agriculture and scientific research with respect to natural resources and fiscal management. The total cost of the programme for the first year was estimated at \$85 million. The contributions by the member countries of the United Nations were voluntary, but no stipulations by the contributing governments regarding the use of the funds were permitted. The contributions were allocated to and spent by the specialized agencies of the United Nations to help the needy countries at their request in their special field. These agencies, namely, the Food and Agriculture Organization, the World Health Organization, the United Nations Educational, Scientific and Cultural Organization, the International Labour Organization, the International Civil Aviation Organization, the International Tele-Communications Union and the World Meteorological Organization, provide technical assistance to member countries. The programmes are mainly concentrated on the dissemination of improved techniques in the fields of health, education, agriculture and public administration. The IMF makes its contribution to the programme by providing technical assistance to the members on their financial policies and problems without any publicity.

In addition to participating in the International Technical Cooperation programme through the UN and its agencies, the United States provides technical assistance directly to the countries needing it on bilateral basis. In these dealings there is no scope for "Dollar Imperialism".

The Point Four Programme which seeks to encourage the process of economic development of the underdeveloped countries is a dynamic and a continuing programme. The aid through

⁹ *Ibid.*, p. 21

this programme roughly falls into two categories. First is the technical, scientific and managerial knowledge necessary for economic development including technical advice in such fields as sanitation, communications, road buildings, governmental services and in planning for long range development. Secondly, there is the need for producer goods—machinery and equipment and technical assistance—for the development of productive enterprises. For the creation of overheads and social capital there is the need in underdeveloped areas for provision of capital. The International Bank for Reconstruction and Development and the United States Export Import Bank have taken up this task in part. But there still remains a great need to create favourable conditions for increasing the flow of foreign capital. The two problems of providing technical assistance for the general development of the underdeveloped areas and of encouraging the flow of productive capital to them are closely interrelated. President Truman in his message to the Congress on Point Four legislation stated in clear terms that a bolder policy of foreign investments should be adopted.

Many of these conditions of instability in underdeveloped areas which deter foreign investment are themselves a consequence of the lack of economic development which only foreign investment can cure. Therefore, to wait until stable conditions are assured before encouraging the outflow of capital to underdeveloped areas would defer the attainment of our objectives indefinitely. It is necessary to take vigorous action to break out of their vicious circle.¹⁰

The primary beneficiaries of the Point Four Programme are the underdeveloped areas who are keen to utilize their material and human resources more efficiently to raise their own standard of living. But along with the world economy, the United States, the originator and a major participant in the programme, also stands to benefit. The programme will help utilization of minerals and raw materials in the underdeveloped areas, and thus quite a number of materials which are in storage all over the world will be available in greater supply. Simultaneously it will provide purchasing power to the underdeveloped areas for the

¹⁰ *Ibid.*, p. 24

purchase of capital goods which are needed for their economic development Finally by helping the industrial progress of the underdeveloped areas it would facilitate the carrying out of foreign trade on an enlarged scale

CHAPTER IV

INDIA'S ECONOMIC DEVELOPMENT DURING THE FIRST FIVE YEAR PLAN

It would be useful to start with a consideration of the economic conditions in India right after Independence. Perhaps the most reliable source of information in this respect is the first report of the National Income Committee appointed on 4 August 1949 which furnished the Government with an estimate of the national income for 1948-49. The national income of the Indian Union (net national output at factor cost) for the year 1948-49 was estimated by the Committee at Rs 8,710 crores. Since the estimated population in 1948 was 341 million the national income per capita came out to be Rs 255. Table 3 shows the national income of the Indian Union in 1948-49 industry-wise according to its origin.

TABLE 3
NATIONAL INCOME OF THE INDIAN UNION 1948-49
(by industrial origin)

Item	Net output		Number of persons engaged (lakhs)	Net output per person (thousands of rupees)
	(crores of rupees)	(percen- tage)		
1 Agriculture	4,150	47.6	905	0.5
2 Mining, manufacture and hand trades	1,500	17.0	187	0.8
3 Commerce, Transport and Communication	1,700	19.5	107	1.6
4 Services	1,360	15.9	128	1.1
5 Net national output at factor cost	8,710	100.0	.	.

The absolute importance of agriculture in the Indian economy is shown by the fact that the largest number of people (905 lakhs) were engaged in agriculture and were producing products worth Rs 4,150 crores. This means that nearly 48 per

cent of the total national income came from agriculture. Yet it is at the same time obvious that the productivity per person in agriculture has been the lowest. Next in importance from the point of view of the contribution to national income was commerce, transport, and communications which gave rise to about 20 per cent of the national income as compared to mining and manufacturing which in spite of the larger number of people engaged produced only 17 per cent of the national income.

A further break up of the origin of national income has been given in Statement I which shows that the net output per person engaged in the railways and communications was greater than in banking, insurance and commerce. It may also be noted that in the category of mining and manufacturing, small enterprises had greater importance from the point of view of employment as well as of total net output. Yet productivity per worker in the small enterprises was less than even half of that in mining and manufacturing. (For Statements, see pp. 135-60.)

This shows that Indian economy had not reached the stage where the free forces of capitalist economy work. Although agriculture was the most important occupation there has been nothing like an agricultural revolution which had preceded the industrial revolutions in almost all cases. In the matter of industries the relative backwardness of the country is obvious from the predominantly greater importance of small enterprises. Even the mercantile capital did not make any great headway as is evident from the relatively greater importance of railways and communications rather than banking, insurance and commerce. This leads one to suspect that in any comprehensive planning efforts could have been made to develop both agriculture and industry. It was not a question of either agriculture or industry but since both of them were underdeveloped it was necessary to stimulate the progress of both. For the stimulation of progress, however, there was a great necessity for building up power projects, developing means of communication and for the building up of social overheads on which a sound base for the development of agriculture and industry could be established.

It was with this perspective in mind that India agreed to cooperate with the South East Asian countries on the programme for economic development at the Commonwealth Foreign Ministers' Conference held at Colombo in January 1950, com-

monly known as the **Colombo Plan**. The main object of this plan was to stimulate the productive capacity of the countries of South and South-East Asia. A permanent Consultative Committee of the Commonwealth Governments was formed to recommend from time to time the extent of financial and technical assistance to be given to individual countries. The plan in the first instance was estimated to cost £1,868 million spread over a period of six years that is, 1951-57 covering India, Pakistan, Ceylon, Malaya, and British Borneo. The country-wise break-up of the expenditure has been shown in Table 4.

TABLE 4
COUNTRY-WISE BREAK-UP OF EXPENDITURE
(in million £)

Item	India	Pakistan	Ceylon	Malaya and British Borneo	Total	Percentage
Agriculture	456	88	38	13	595	32
Transport and communications	527	57	22	21	627	34
Fuel and power	43	51	8	20	122	6
Industry and mining	135	53	6		194	10
Social capital	218	31	28	53	330	18
Total	1,379	280	102	107	1,868	100

The programme for India included the multipurpose projects of Damodar Valley, Hirakud and Bhakra Nangal, the integrated production programme for food grains, cotton, jute and other crops, the development of transport facilities and, the public health and education schemes.

It was proposed that every country would contribute about 42 per cent of the cost from her internal resources. Part of the external finance in the case of India was proposed to be met by the release of sterling balances (which India had accumulated during World War II) to the extent of £ 211 million. The rest was to be financed by loans and grants from other governments or international institutions, or by an inflow of private foreign capital. The Colombo Plan officially came into effect on 1 July 1951.

However, since the discussion was going on much earlier and the Government of India had to submit her development schemes to be integrated in the Colombo Plan it became necessary for the Government of India to make a careful appraisal of the available resources and an objective analysis of the economic issues involved. This led to the appointment of the Planning Commission whose personnel and terms of reference were announced on 15 March 1950. In July 1951 the Commission published the draft outline of the First Five Year Plan covering the period from 1951-52 to 1955-56 with an estimated expenditure of Rs 1,493 crores distributed among the various items as under

	(Rs crores)
Agriculture and Community Development	192
Irrigation and Power	450
Transport and Communications	388
Industry	101
Social Services	254
Rehabilitation	79
Miscellaneous	29
	<hr/>
Total	1,493
	<hr/>

While the draft of the plan put the main reliance on internal resources for the financing of economic development yet the realistic attitude which was shown in the formulation of the Plan generally improved the prospects for foreign aid both official and private. It was also possible for India to present a more integrated scheme for the six year Colombo Plan at the first meeting of the Colombo Plan Consultative Committee held in Karachi in March 1952. India's revised six-year Colombo Plan involved an outlay of Rs 2,333.7 crores as against Rs 1,839.6 crores which was previously planned for. Out of the total outlay of Rs 2,333.7 crores India agreed to raise as much as Rs 1,551 crores from internal resources leaving a gap of Rs 782.7 crores to be provided by external aid.

The draft outline led to discussion in various sectors of the

country and ultimately the *First Five Year Plan* in its final shape was published. While the total expenditure involved was raised from Rs 1,493 crores (as mentioned in the draft) to Rs 2,069 crores in the final Plan, the distribution of expenditure among the various heads did not show any fundamental change in the matter of priorities. Table 5 showing the comparative distribution of expenditure between the draft and the final Plan on various heads indicates the maintenance of priorities.

TABLE 5

DISTRIBUTION OF EXPENDITURE IN THE DRAFT
OUTLINE AND THE FINAL PLAN
(in crores of rupees)

	<i>First Five Year Plan</i>	<i>Draft outline</i>	<i>Percentage in the First Five Year Plan</i>	<i>Percentage in the Draft</i>
Agriculture and Community Development	360	192	17.4	12.8
Irrigation and Power	561	450	27.2	30.2
Transport and Communications	497	388	24.0	26.1
Industry	173	101	8.4	6.7
Social Services	340	254	16.4	17.0
Rehabilitation	85	79	4.1	5.3
Miscellaneous	53	29	2.5	1.9
Total	2 069	1 493	100.0	100.0

The figures given in Table 5 show that the outlay of the public sector detailed as much as 69 per cent of the total expenditure planned for agriculture, irrigation and power transport and communications which was necessary for more intensified industrial development at a later stage. The high priority given to agriculture and basic services inevitably limited the powers of the public sector to participate in industry. As a matter of fact industrial development was to be left to the private sector by the internal as well as the external entrepreneurs. This was exactly in accordance with the Schumpeterian system with the difference that in the case of the Schumpeterian system (which primarily explained the functioning of the system of a well organized society) there was no need for expenditure by the State on overheads and the

capitalists could themselves bring about economic development by means of innovations, whereas in India public expenditure was needed to give a sort of push to the economic activity and to the productive potential of the community in the wide sense. In other words, public expenditure was meant to add to the productive potential in both the private and public sectors. Viewed from this angle the Planning Commission envisaged the significance of the total outlay of Rs 2 069 crores from the following rough classification

(Rs crores)

1	Outlay which will add to the stock of productive capital owned by the Central and State Governments	1,199
2	Outlay which will contribute to building up productive capital in the private sector (Rs 396 crores)	
	(a) Expenditure on agricultural and rural development (excluding community projects and provision for scarcity affected areas)	244
	(b) Loans for Transport and Industry	47
	(c) Provision for stimulating local development (community projects and local works)	105
3	Outlay on Social Capital	425
4	Outlay unclassified above (including provision for scarcity affected areas)	49
	Total	<hr/> 2 069 <hr/>

Thus nearly 60 per cent of the total outlay was expected to result in productive capital in the ownership of the Central and State Governments mainly under irrigation and power, transport, communication and industry. The rest was meant for productive equipment in the private sector. It was not possible for the State to make large investments in industry and as a matter of fact it was not considered necessary. Private industry was considered to play an important role in the mixed economy. The State was to control and direct investments for the co-ordination between public and private sectors. This was exactly

in accordance with the Government of India's Industrial Policy as issued by the Ministry of Industry and Supply on 6 April 1948. It was announced that the Government would manufacture arms and ammunition and participate in the production and control of atomic energy, and in the ownership and management of railway transport. In an emergency the Government was to have power to take over any industry vital for national defence. In the case of production of coal, iron and steel, aircraft manufacture, shipbuilding, manufacture of telephone, telegraphs and wireless (excluding radio receiving sets) and mineral oils, the State was given the exclusive responsibility for establishing new undertakings, and it was decided that for a period of ten years existing undertakings would be allowed to function. The rest of the industrial field was normally considered to be open to private enterprise, individual as well as cooperative. This policy was generally endorsed by the Planning Commission when it accepted mixed economy as a suitable basis for the industrial development of the country. In December 1954 the industrial policy of the Government was reviewed in the Lok Sabha and it was found to be in general conformity with the earlier statement. It was further decided that the objective of the Government's policy would be to establish a "socialistic pattern of society" suited to Indian conditions, and towards that end the tempo of economic activity in general and of industrial development in particular was to be stepped up to the maximum possible extent.

In accordance with this policy the Government provided financial facilities on an increasing scale to industries in the private sector. For instance, in 1952-53 the activities of the Industrial Finance Corporation were widened. In the same year the Steel Corporation of Bengal Limited was merged with the Indian Iron and Steel Co. Ltd. so that the steel industry could expand in the private sector. The IBRD and the Government of India both provided loans to assist the company in its further expansion in 1953-54. The maximum limit of the loan which the Industrial Finance Corporation could grant to an individual borrower was raised from Rs. 50 lakhs to Rs. 1 crore. One very important provision was made empowering the Government of India to guarantee loans in foreign currencies, which the Corporation would seek from the IBRD or from other sources for purposes of making advances to industrial concerns. A

year later further steps were taken for the expansion of financial facilities to the private sector. In 1954, 371 licences were granted under the Industries Development and Regulation Act mainly for the setting up of new undertakings. Thus, besides the provision of basic economic facilities such as transport and power, the Government was all through assisting industrial development in the private sector by appropriate fiscal and other measures, and by fostering institutions to provide financial aid to these industries. The states too were to establish State Industrial Finance Corporations meant for giving assistance to private industrial enterprise within the states. And finally, the Industrial Credit and Investment Corporation of India Ltd. was established by private sponsorship and was assisted by the Government of India and the IBRD for encouraging private external and internal enterprise.

It was, however, realized that domestic resources were not sufficient to incur an expenditure in the public sector to the extent of Rs. 2,069 crores. The total savings from current revenue were estimated to be of the order of Rs. 788 crores and the capital receipts (excluding withdrawals for reserves) to be Rs. 520 crores. Thus the total budgetary resources of the First Five Year Plan were Rs. 1,258 crores. A gap of Rs. 811 crores was envisaged which had to be covered by deficit financing and external assistance. Out of this gap, Rs. 156 crores had already been received from the following sources:

	<i>Rs. crores</i>
Commonwealth Assistance under the Colombo Plan	12
Assistance under Technical Cooperation Agreement 1952	25
Assistance under the First Supplement to Technical Cooperation Agreement 1952	18
United States Food Loan	90
Proceeds of Loans from International Bank 1950	9
Other aids	2
Total	156

This still left a gap of Rs 655 crores to be covered through further external assistance, or increased taxation and domestic borrowing. The Commission believed that deficit financing to the extent of Rs 290 crores, which was roughly equal to the sterling balances to be released during the First Plan period, was possible. In this way a gap of Rs 365 crores was left uncovered.

So far as the assistance already granted to India was concerned India had received under the Colombo Plan an amount of Canadian \$15 million from Canada (\$10 million for the purchase of wheat from Canada and the rest for the Bombay Transport Scheme), £ A 4.2 million from Australia (£A 3.7 million in the shape of wheat and flour) and £250,000 from New Zealand. It was also agreed that the sale proceeds of the wheat from Canada and Australia would be credited to a Special Development Fund, and that the sale proceeds of wheat from Canada were to be specially used for the construction of the Mayurakshi Project.

We have already noted the aims and objectives of the Point Four Programme. Under this programme the aid receiving countries were to conclude bilateral agreements with the USA, specifying that due publicity would be given to projects to be financed by the programme, and that they would contribute at least a part of the cost in local currency. India concluded an agreement with the United States in terms of the Point Four Programme on 28 December 1950, according to which \$1.2 million were allocated to India. Five specific projects were mentioned in which two related to agricultural development, one to child welfare, and two for the purpose of US geologists making investigations about water and mineral resources in India. Another such Indo-US agreement was signed under the Indo-US Technical Cooperation in January 1952, according to which a sum of \$50 million was to be deposited in Fund A, called the Indo-American Technical Cooperation Fund. It was also agreed that salaries of the US technical experts and the cost of the Indian trainees would be paid by the US Government from Funds other than the Fund A. Indian Government agreed to contribute Rs 25 crores to Fund B. The total amount of both the funds exceeded Rs 50 crores and the projects to be financed by these funds were related

to increasing the agricultural efficiency and food production

The joint funds were meant among other things to facilitate implementation on a big scale of the Community Development Projects as envisaged by the Planning Commission. It was decided to immediately start 55 community project centres covering a population of 10 million. Eleven operational agreements were signed providing finance to the different projects as shown in Table 6

TABLE 6
FINANCE PROVIDED TO DIFFERENT PROJECTS

<i>Projects</i>	<i>US contribution (millions of dollars)</i>	<i>Indian contribution (lakhs of rupees)</i>
1 Supply of Fertilizers	10.65	44.00
2 Supply of Iron and Steel	8.39	12.00
3 Locust Control	0.23	2.48
4 Research on Soil and the use of Fertilizers	0.20	8.43
5 Development of Marine Fisheries	2.48	68.95
6 Ground Water Irrigation (2 000 tube wells)	13.70	444.50
7 Training of Village Level Workers	0.17	75.37
8 Community Development Programme	8.67	3 438.34
9 Malaria Control	0.65	0.37
10 Forest Research and Desert Control	0.10	2.08
11 River Valley Schemes	4.76	5.00
Total	50.00	4 101.52

India had also approached the US Government for an *ad hoc* assistance of two million tons of foodgrains during 1950-51. The US Government in its turn enacted on 15 June 1951 the India Emergency Food Aid Act under which India was to be given a long term loan of \$100 million for the purchase of two million tons of food grains during the period ending June 1952. The loan bore a rate of interest of 2½ per cent. It was also decided that the sale proceeds would be deposited in a Special Development Fund meant for short and medium term loans and in special cases grants to State governments for purposes of agricultural development. Out of the interest paid a sum up to

\$5 million was to be used for purposes of training Indians in USA and US citizens in India, and for the purchase of scientific books from America.

On 18 August 1949 the IBRD granted a loan of \$34 million to the Government of India for railway development to be utilized in the purchase of locomotives, boilers, and locomotive parts. The loan is for a period of 15 years, with amortization payments to begin in August 1950. The interest rate is 3 per cent plus the usual 1 per cent commission. This loan amount was reduced on 16 May 1950 at the request of the Government of India to \$32.8 million which was disbursed by March 1951.

It is thus obvious that all the assistance and loans were meant either for financing the food deficits or for building up the future capacity in agriculture and means of communication and transport. This is in accordance with the theory of economic progress of underdeveloped areas in that it is a prerequisite development that a surplus of food production be available on which the income generated in the process of development may be spent and that some funds be spent on the developmental projects and communication which may establish a base for future agricultural and industrial production.

Statements II A and II B give a detailed account of the assistance given to India by various agencies. It will be noted that out of the loans and credits to be repaid in foreign currencies the one single biggest loan of the order of Rs. 90.31 crores was from the United States for the purchase of food grains, which has already been discussed. It may be noted that the whole of this amount had been utilized by the end of the First Five Year Plan. Next in importance was the loan of Rs. 63.07 crores from the USSR for Bhilai Steel Plant, which was not utilized during the First Five Year Plan and the whole of it was available during the Second Five Year Plan. We have already mentioned the loan of Rs. 15.61 crores (\$32.8 million) for railway rehabilitation. The other loans sanctioned by the IBRD during the First Five Year Plan were as given below.

A loan of Rs. 3.43 crores was disbursed out of a larger original amount sanctioned, that is, \$10 million but reduced from time to time at the request of the Government of India. It carried a rate of interest of 3½ per cent and was to be repaid by 1959. The loan was specially meant to finance the import of equipment.

for the reclamation of land by clearing jungles and the weed-infested land. The whole of the amount released had been utilized by the end of the First Plan.

Two loans worth Rs 796 crores and Rs 500 crores were granted to the Damodar Valley Corporation in 1950 and 1953, respectively, and were used for multi purpose projects of electric power development, flood control, and irrigation. It was envisaged that the completion of the project will provide electrical energy for the expansion and development of industry in the minerally rich areas of West Bengal, and will also help flood control and agricultural development by providing irrigation. The first loan of Rs 796 crores was for a period of twenty years at 4 per cent rate of interest. Its repayment was to begin in 1955. The second loan of Rs 500 crores was for twenty five years at a rate of interest of 4½ per cent. The first loan was used up fully during the First Plan, but the second was used only to the extent of Rs 196 crores leaving a balance of Rs 304 crores for utilization in the Second Plan.

For the construction of a thermal plant located at Trombay to be owned and managed by three companies of the Tatas, the IBRD disbursed Rs 664 crores. This plant was meant to provide electric power in Bombay State and facilitate the industrial development of the area. Out of this only Rs 209 crores was utilized leaving a balance of Rs 455 crores to be used during the Second Plan.

It was the first time for the private sector to receive official assistance when the IBRD made a direct loan of Rs 1429 crores to the Indian Iron and Steel Company to finance a five year expansion programme of the Company. It was to double the steel production capacity and to increase the output of iron from 160,000 tons to 400,000 tons thus increasing India's finished steel capacity by about 33 per cent and that of iron by 200 per cent. The amount utilized during the First Plan was Rs 278 crores leaving Rs 1151 crores for the Second Plan.

Analysis of these loans shows that the main objective for which the IBRD was prepared to grant loans was development of the over-heads to build the base for the agricultural and industrial development. In matters of industrial expansion, the Bank's policy has been to mobilize private resources, internal and external, for the use of productive enterprise. It was in pur-

suance of this policy that it advanced a loan of Rs 4 76 crores to the Industrial Credit and Investment Corporation of India Ltd which is a privately sponsored institution formed for the purpose of assisting private industrial enterprise by attracting internal and external investors and stimulating the growth of India's capital market. The loan was meant for the purchase of imported material, equipment and services. It was for a period of fifteen years bearing a rate of interest of 4½ per cent, repayment of the principal and the interest thereon guaranteed by the Government of India.

The Industrial Credit and Investment Corporation of India Ltd was registered under the Indian Companies Act on 5 January 1955 for the purpose of expanding and modernizing private enterprises, encouraging and promoting the internal and external private capital in such enterprises, and for promoting private ownership of the industries. It would provide finance in the form of medium term loans and equity capital, sponsor issue of shares and securities, guarantee loans from other private sources, make funds available by re-investment, and furnish managerial, technical and administrative assistance.

The authorized capital of the Corporation is Rs 25 crores in which the British Eastern Exchange Bank, Insurance Companies of the UK and other Commonwealth countries, and the US Corporation have greatly participated. The Corporation will take steps to ensure that there is no undue concentration of power. The Government of India have also agreed to advance Rs 7.5 crores free of interest repayable in fifteen equal instalments after the expiry of fifteen years from the date of advance.

It is, therefore, obvious that the IBRD as well as the Government of India feel that after the necessary overheads have been built, private capital will be capable of bringing about rapid economic development of the country, and while it is possible to build up a socialistic pattern of society in India it is not necessary to curb private enterprise altogether. The State is required to take over ownership of primary resources in the early stages of economic development in order to build up a society in which individuals are given freedom to choose from among a wide range of possible avenues open to them. In his speech at the AICC meeting on 11 May 1958 our Prime Minister suggested that a

distribution of income could not come about in the early stages of economic development and a considerable degree of decentralization was needed for the functioning of the economic system in India. He has very aptly stated

Marx is a famous name and many things were done by applying his theories. But many of the things explained by him do not exist today. And many of his predictions have proved to be incorrect. Marx did not envisage the extremely prosperous America. Capitalism has shown amazing strength to adapt itself to circumstances. Scandinavia is a semi-socialist, but fundamentally, a capitalistic State, with a higher standard of life.

The concept of socialism is changing even in the Western countries, therefore, we in India have to be more wide awake, and the conditions ultimately are governed by the state of our people, state of their minds.¹

During the First Five Year Plan the United States also gave a loan of Rs 39.28 crores under the Technical Cooperation Administration which was to be repaid in Indian currency and did not create any difficulties of foreign exchange.

In addition to these loans, grants worth Rs 154.34 crores were made—Rs 5.61 crores by the Ford Foundation, Rs 46.19 crores under Colombo Plan, and Rs 102.54 crores under the Technical Cooperation Administration. Out of these grants only Rs 87.19 crores were utilized during the First Plan leaving a balance of Rs 67.15 crores for utilization in the Second Plan.

We have noted in the last chapter the imperative need of foreign capital in the early stages of economic development so much so that in some of the now advanced countries like the US and Canada there were periods of expansion when the inflow of foreign capital was so extensive that the current surplus was not sufficient for servicing and repayment of capital and that new loans had to be taken for repayment of the old ones. It had been realized since the very beginning of India's independence that the use of foreign capital was inevitable for the development of the economy. It was also recognized, as pointed out by the Prime Minister in his announcement of the policy regard-

¹ AICC Economic Review, Vol. X, No. 2, 15 May 1958, p. 4.

ing foreign capital in India that Indian capital had to be supplemented by foreign capital not only because it was necessary for rapid economic development but also because in many cases the scientific technical and industrial knowledge which was required by the country for its development would accompany the foreign capital. A clear cut policy of providing facilities for the transfer of earnings and repayment of capital in case of nationalization was also announced. The result therefore was that direct investment from foreign countries like the UK and the USA was on the increase. Direct investment may be defined as the one in which foreign investors have a controlling interest in the business concerns of India. This type of investment was more than three fourths of the total foreign investment in India at the end of 1955. This investment is largely in the form of holdings in branches and subsidiaries. Table 7 giving the total direct foreign investment in 1953 and 1955 indicates that in recent years investment increased in all the fields but the largest increase was in the case of the manufacturing industries in which the net foreign liabilities were more than doubled.

TABLE 7

FOREIGN INVESTMENTS IN 1953 AND 1955 IN INDIA
(OF UK AND US COMPANIES COMBINED)
(in lakhs of rupees)

<i>Item</i>	<i>1953</i>	<i>1955</i>
Manufacturing	4 998	10 797
Trading	8 262	9 242
Plantations	6 324	8 000
Others	2 273	2 808
Total	21 857	30 847

A break up of this total investment between the UK and US Companies is interesting insofar as it reveals that investments by the UK companies have been in the plantations and the trading organizations and those by the US companies which started comparatively recently have been increasingly in the manufacturing and other allied activities. Since the relations with the UK companies must have originated in the past it shows

that capital investment in the past was mainly directed to the plantations and other commercial activities because of the lack of purchasing power of domestic consumers and the expanding markets for raw materials during the nineteenth and the beginning of the twentieth centuries. But the pattern of investment is now changing and foreigners are now investing to a greater extent in the manufacturing industries. Table 8 showing the break-up of the total foreign investment among the US and UK companies clearly reveals this phenomenon.

TABLE 8

BREAK UP OF THE INVESTMENTS OF UK AND US
COMPANIES IN INDIA IN 1953 AND 1955

(in lakhs of rupees)

Item	Capital invested by			
	UK companies		US companies	
	1953	1955	1953	1955
Manufacturing	4,521	9,445	477	1352
Trading	6,390	6,938		
Plantations	6,324	8,000		
Others	2,271	2,808	1874	2304
Total	19,506	27,191	2,351	3,656

This clearly indicates that the objection by some of the economists to foreign capital that it is interested only in building up of enclaves is not very sound, and a proper policy in regard to foreign capital can be of great help towards the progress of the country.

Some competent authorities have suggested that the returns on foreign capital in the underdeveloped countries being not very promising it is not possible to attract capital in any great measure. A recent survey* by the Reserve Bank of India on the Returns on Foreign Investments in India during 1953-55 shows that this is not absolutely correct. Statement VII gives a detailed account of the profits (*after tax*) of the UK and US companies combined and separately in various fields of activities. The return on investment to UK and US companies combined together was about 12 per cent in 1953 and 10 per cent in 1955. The higher

* Cf. *Reserve Bank of India Bulletin*, 1958.

percentage of the rate of profits in 1953 is due to the fact that in 1953 the return on the plantations was exceptionally high. Table 9 shows the rates of profits for the combined US and UK companies in the years 1953 and 1955.

TABLE 9

RATES OF PROFITS FOR THE COMBINED U S AND
U K COMPANIES

<i>Item</i>	<i>1953</i>	<i>1955</i>
Manufacturing	10.1	10.8
Trading	7.3	6.5
Plantations	19.3	11.8
Others	13.7	11.3
All activities	12.1	9.9

It should be interesting to note that the rate of profits in trading had not only been less than that in manufacturing in both years but had also diminished absolutely in 1955 as compared to 1953, whereas the rate of return in manufacturing had slightly increased in 1955.

Another point of interest to be noted is that foreign companies in India are earning a higher rate of profits as compared to the earnings by capital in their own countries. For instance, US capital has been getting a rate of return of about 13 per cent in India while at home the earnings ranged between 10 and 12 per cent during 1953-55. Similarly British capital earned a rate of return of 12 per cent in 1953 and above 9 per cent in 1955 in India when the comparative figures in the UK ranged between 8 and 9 per cent.

Direct investment is sometimes objected to because of the greater domination by outsiders in the economic activities of the country. A comparatively recently freed country like India has greater reason to fear because foreign capital in the past had been associated with colonialism and imperialism. A new scheme, therefore, has been of a joint ventures of foreign investors with the Indian Government and in some cases with Indian investors participating. For instance in the year 1951-52, the Indian Government signed agreements with two foreign companies, Standard Vacuum Oil Company of New York and the Burmah

Shell Oil Company, for setting up two refineries in Bombay estimated to cost \$35 million and Rs 22 crores respectively. The companies have assured the government that they would provide training and employment to Indian personnel in refinery operations. In 1952-53 another agreement similar to the previous ones was signed with Caltex for the establishment of an oil refinery at Visakhapatnam. In the following year an agreement was reached between the Government of India and the German combine of Krupps and Demag for the establishment of a steel plant in Orissa.

The Government of India have realized the importance of private capital, both internal and external, and also recognized the importance of private management even in public owned industries. They have, therefore, followed a policy of converting industrial undertakings financed by them into private limited companies working under government supervision. For instance, in the year 1952-53, a private limited company, the Hindustan Machine Tools Limited, in which 85 per cent of the share capital is owned by the Government and the rest by the Swiss firm of Oerlikons, was given the management of the Machine Tools Factory at Jalahalli as from 1 March 1953. The Hindustan Housing Factory Limited was incorporated as a private company with Government and Messrs. Baskha Singh—Wallenberg Limited as equal partners. Similarly the management and control of the Telephone Cables Factory at Rupnarainpur has been transferred to a private limited company, the Hindustan Cables Limited.

This indicates that a joint venture between the Government and internal and external private entrepreneurs has been considered to be a solution which gives the advantages both of private direct investment and internal policy of comprehensive planning.

India's foreign trade policy during the First Five Year Plan was based on the idea of expanding the productive capacity inside the country and therefore the whole question of balance of payments and foreign trade must be viewed accordingly.

Statement III A and III B show the principal exports and imports during the planning period. In the year 1950-51 we find a slight deficit on current mercantile account to the extent of Rs 2,657 lakhs. In the first half of the year there was actually an improvement which was due to the devaluation of the rupee.

and the Korean War. In the first quarter, there was an initial impact of the accelerated rearmament and stockpiling in the United States and Western Europe. In the second quarter, however, exports increased considerably and imports showed appreciable decline mainly due to the shortages abroad. The great improvement was in relation to the sterling area. However, the devaluation of rupee gave a competitive advantage to textiles over others especially from the USA and Japan in the world market.

But during the last two quarters the trade policy of the country was directed from the point of view of increasing the supplies of goods required for economic development as well as essential consumption goods. This objective was achieved by means of the US Wheat Loan and drawings from the IBRD loans which made it possible for the country to finance the deficit in the balance of payments.

The year 1951-52 can be divided into two periods from the point of view of the trade policy pursued. In the first two quarters the country continued its trade policy of the previous year. The main aim of the policy was to liberalize imports so that industries could have sufficient raw materials needed currently and they could also build up inventories for the future, and there was a sort of restriction on exports to make sufficient amount of supply available to face the increased demand inside the country. Later in the year, however, stockpiling abroad was reduced and the boom turned into a slight recession. As a result of this India had to change her policy and she liberalized exports although the import policy continued unchanged. However, the changes in the export policy were so late that they could not affect the balance of payments of the year. The year is specially noteworthy for the huge imports of grains, pulses and flour, financed by the US Wheat Loan. It will also be noted that in this year there were increased imports of raw cotton and machinery for purposes of industrial expansion. Though promises of assistance were given by the Commonwealth countries under the Colombo Plan these did not at all affect the balance of payments position during 1951-52 because the greater part of the assistance was received after March 1952.

In 1952-53, India again followed a policy of promoting exports, which had received a set-back subsequent to the Korean War.

boom Three measures were adopted to increase exports The most important of them was the reduction in export duties on jute goods, raw cotton, and cotton textiles Then there was a liberalization in export quotas of a number of commodities and some of the important ones like cotton textiles and jute were placed on the free licensing list And finally, substantial financial assistance was given to jute producers for the sale of jute products in the United States

As regards imports, in the first half of the year the policy was a somewhat restrictive one because it was realized that in the previous year sufficient stocks had accumulated and there was no need for increasing the imports of these commodities, that is, raw materials and producer goods But late in the year, imports of certain items of machinery and essential consumer goods were again liberalized

In spite of these policies, there was a deficit to the tune of Rs 9,754 lakhs This deficit was financed partly by the US Wheat Loan and partly by the assistance made available under the Colombo Plan from Australia, Canada and New Zealand Statement IV indicates that though there had been a considerable influx of foreign loans in the year, there was a larger outflow of long term private capital from the country and a deficit of Rs 46 crores had to be met

In 1953-54, there was a considerable fall in the level of trade The value of imports, however, declined more than that of exports There was a sharp decline in the import of food grains due to the improvement of food production inside the country In the case of exports there was a considerable decline in the earnings from jute exports The increased requirements of raw materials were mostly met from indigenous sources Thus the imports of raw cotton and raw jute both declined during this period Yet the import policy in regard to machinery was liberalized There was a decline in the export of jute and cotton textiles but tea showed an improvement The main reason for this was the increased demand from the UK due to the abolition of sugar rationing in England In the case of net invisible receipts there were some receipts under the Colombo Plan Indo US Technical Cooperation Agreement, and the Ford Foundation But they were more than offset by a fall in the net receipts on other transactions like private donations and miscellaneous services

During the year 1954-55 a more liberal import policy designed to assist the progress of industrial development was pursued. There was a rising tempo of developmental expenditure which would have been sharper but for the fact that food position was considerably improved. There were increased imports of raw materials, machinery and consumers' goods. However, in the case of certain goods which were being produced inside the country import quotas were cut down. For instance the import quotas of jams and jellies, table fans, and many engineering stocks were reduced. Thus on the whole imports of food grains financed by foreign assistance diminished, but on the other hand, imports of non food items on Government account, not financed by aid, increased to some extent. In the case of exports, earnings increased considerably in three principal commodities of export namely, jute cotton manufactures and tea. This was in accordance with the export promotion policy of the Government of India.

The pattern of external trade during 1955-56 again indicates a rise in the tempo of India's developmental efforts. We find that after the Korean War boom the amount of imports was the highest. This was especially due to the heavy imports of machinery and iron and steel which show the record figures for the whole period. The export receipts during 1955-56 went up by 7.6 per cent over the previous year's. This rise was mainly due to raw cotton and vegetable oils. Nevertheless there was a deficit in the balance of trade of Rs. 8,798 lakhs.

It may be useful to sum up India's position as regards the balance of payments during the First Five Year Plan in the light of economic policy and the economic conditions inside the country as well as outside. During 1951-52 exports touched the record figure for the period but in the same year the level of imports was still higher (and the highest during the First Plan period) because of a significant rate of investment resulting in imports of machinery and also because of large imports of food grains due to the food shortage in the country. As a result the current deficit was the highest during the whole plan period. In the two years which followed (1952-53 and 1953-54) the boom due to the Korean War came to an end and a recession set in in the United States. This led to a considerable fall in exports but there was a simultaneous slowing down of the rate of private

investment and also an improvement in the food situation which led to a considerably diminution in imports. If we exclude the official donations we would find that during these two years there was a surplus of Rs 50 and Rs 28 crores respectively. During the last two years of the Plan both exports and imports increased progressively and in 1955-56 reached the highest level since 1951-52. The rate of developmental expenditure was accelerated and therefore there was a substantial increase in imports of machinery and iron and steel manufacture, and some raw materials like cotton and jute. During this period the American recovery started and our exports also increased but not to the same extent as imports. Therefore the current balance of payments excluding the official donations showed deficits during these two years.

Excluding the official donations deficit during the First Five Year Plan period was Rs 123 crores—much less than estimated. This smaller deficit was due in the first place to lower imports of food grains, made possible by favourable monsoons and food production in the country and partly on account of the smaller rate of investment than anticipated by the Planning Commission. However, during this period larger official receipts amounting to Rs 197 crores were obtained which made it possible to finance the deficit.

The overall statement of the position of the balance of payments on current account does not give a clear idea of the pattern of trade and trade relations with different areas. Statement V gives a region-wise summary of India's balance of payments on current account and it should be interesting to analyse its pattern.

Before the planning period began it was found that it was in regard to the sterling area that there was the largest improvement in India's balance of payments in 1950. This was quite expected after the devaluation of pound sterling and Indian rupee in terms of dollars in September 1959. In 1950, the balance of payments position with the hard currency area had also improved and the deficit in 1949 was turned into a surplus. This was due to the intensified stockpiling during the Korean War and the consequent rise in the prices of Indian exports. In other areas the adverse balance of payments diminished to some extent which was again due to the rise in exports rather than a fall in imports.

In 1951, although there was a deficit in current account with all areas taken together, there was an improvement of the trade balance with the sterling area. There were larger exports of jute goods, tea and spices to these areas accompanied by higher prices of the commodities. On the imports side the increase with the sterling area was on account of the commercial imports. The imports on government account, especially of food from Australia, diminished. The payments position with the hard currency area changed from a surplus in 1950 to a deficit in 1951. Commercial imports of raw cotton, machinery, and essential goods increased considerably in 1951. Expenditure on Government account also increased specially because of the purchase of food grains, supplies of which were not available in the soft currency area. The balance of payments with all the other countries further deteriorated because of larger commercial imports from European countries and larger food imports particularly from China.

During 1952 the surplus with the sterling area increased considerably but since in the previous year there was a large deficit with Pakistan, the position of sterling area including Pakistan slightly deteriorated and the surplus on current account diminished. Import restrictions in countries like Australia and the lightening of the credit in this area led to the diminution of exports of Indian commodities. The position with the dollar area further deteriorated and the deficit increased mainly on account of lower prices of the exported commodities and increased imports on Government account of raw materials. The balance with the OEEC countries showed a deficit as in the previous years. While private imports declined those on Government account increased. However, there was a considerable improvement in the balance of payments with the rest of the non-sterling area. This was due to the reduced payments for raw cotton from Egypt and Sudan and the increased shipments to Japan.

The year 1953-54 shows a remarkable change in the balance of payments of India vis a vis different regions. There was improvement with respect to the dollar area, the reduced payments for imports being a major contributor. Imports of food on Government account diminished. The exports also declined but much less than the imports. There was also a surplus with the non sterling area excluding the OEEC countries, which was

due to the fall in the imports of food from China and Thailand and the maintenance of exports at the same level as previously. The decline in exports of cotton textiles to these areas was counter balanced by the increase in exports of jute and tea. On the other hand trade balances of the sterling area and the OEEC countries declined and showed a net deficit during the year, yet the OEEC countries were the only ones in which the balance of payments worsened the most—the deficit more than doubled. The exports of jute manufactures and imports on Government account increased substantially.

During 1954-55, the payments position with the sterling area further worsened because of the increased imports of machinery. The balance of payments with the dollar area further deteriorated because of the higher imports on private accounts specially of raw cotton. There was however, a diminution in food imports on Government account. The exports, specially those of metallic ores and black pepper declined considerably. In the case of OEEC countries the balance of payments deficit increased further because of the increased imports on both private and government accounts. The imports of machinery and rayon textiles considerably increased while there were large imports of sugar and stores on Government account from this area. The surplus balance with the rest of the non-sterling area remained stationary.

In the last year of the First Five Year Plan exports to the OEEC countries, the rest of the non sterling area and the dollar area increased. However in the case of the OEEC countries and the rest of the non sterling area the increase in imports was more than offset by the increase in exports. The current surplus with the dollar area increased but it was due entirely to the official donations otherwise on mercantile account there was a deficit. Similarly in the case of the sterling area the surplus balance of payments was due to the invisibles.

This analysis reveals interesting trends in trade relations with respect to different areas. The first thing worthy of note is the well established trade relations with the sterling area. The value of our exports as well as imports has been the highest in this region. But with the developmental expenditure generally associated with a deficit balance of payments on mercantile account, we find that India's balance of payments on current account has been constantly deteriorating with the sterling area. The small

surplus in the previous year converted itself into a deficit which has been on the increase since the commencement of the First Plan. But since the trade and commercial relations with this area are well established our earnings on the invisible account have been sufficiently high to more than counter balance the deficit on the trade account. Yet as can naturally be expected, the favourable balance of payments on current account including invisibles, has been diminishing due to the higher level of developmental expenditure.

The second point to note is that our trade relations with the dollar area have been improving, we are importing, in the first instance, food from the US and then machinery and raw materials for purposes of economic development. It is, therefore, natural that our trade balances on mercantile account show a deficit with this area. Our invisible earnings from this area have not been very high, and as such the deficit almost throughout could be made good by the official donations from this area. The trade relations with the OEEC countries have been interesting. While we have not been exporting to these countries to any great extent, our imports from them have always been of a substantial magnitude. Moreover, not only did we not have any invisible earnings with respect to these countries, they were rather negative. Finally, since the European countries were themselves engaged in the programme of reconstruction they were not in a position to extend donations to us. Thus we have always been having a deficit balance of payments with these countries and with the progress of the developmental expenditure it has been increasing. The case of the rest of the non sterling area is of special importance to us because not only have our exports been greater than imports during the First Plan, but also the other invisible earnings have been positive so that in general we have had a favourable balance of payments throughout.

This shows the great necessity of having a multilateral trading system and the free convertibility of currencies which can facilitate the trade relations with different regions and consequently the developmental programmes. Besides, as Statements VI A and VI B indicate, out of our principal commodities of export gunny cloth is the only important commodity which was exported to dollar countries but that too has been showing a tendency

to decline perhaps on account of the substitutes produced in the United States. The biggest market for tea is in the UK and the sterling area, and cotton piece goods and gunny bags are mostly exported to the sterling area and the rest of the non-sterling area. Thus the possible avenues of expanding our export markets appear to be in the non-dollar area whereas with the developmental plans our reliance for imports would be increasingly on the dollar area and the OEEC countries. It is therefore of utmost importance from developmental point of view as well as the expanding world trade relations that there should be full and free convertibility of currencies and the multilateral trading system.

The Commonwealth countries have been giving considerable thought to the problem of achieving full and free convertibility of currencies. Two Commonwealth conferences were held, one in the beginning and the other towards the close of 1952, with a view to studying measures necessary for the achievement of convertibility of the sterling. The first conference was held amidst an acute balance of payments position and a series of corrective measures were recommended. The second conference insisted on unrestricted multilateral trade and convertibility of the sterling as a pre-requisite for the expansion of world trade. The conference laid down three conditions which were necessary for achieving convertibility. It suggested that a continuing effort was necessary on the part of Commonwealth countries to curb inflation. Secondly, it was necessary that the trading nations should adopt policies which led to the expansion of world trade. Lastly, adequate financial support should be made available especially through the International Monetary Fund for stabilizing the trade. It was further decided that the Commonwealth countries should concentrate on the development of projects which would directly or indirectly strengthen the position of the sterling area vis-a-vis the rest of the world.

The Commonwealth Finance Ministers' Conference held in January 1954 approved of the conditions laid down for the convertibility of currencies. They, however, waited for the decision of the United States on the recommendations of the Randall Commission on US Foreign Economic Policy. The Randall Commission, which submitted its report on 23 January 1954, recognized the importance of convertibility of the sterling in the

interest of expanding free world trade The Commission believed that to restore full convertibility of the sterling Britain's resources must be strengthened and that a better utilization be made of IMF's holdings of gold and convertible currencies. The President of the United States approved of the recommendations of the Commission and in his message to the Congress on 30 March 1954 said that the US would support the use of the resources of the IMF for strengthening the position of countries which adopted convertibility. The US Congress, however, did not give its consent to the President's liberal trade programme. The Commonwealth Prime Ministers' Conference held in February 1955 in London reiterated the suggestion for the convertibility of the sterling and the adoption of the multilateral trading system. It, however, recognized that a continuing effort for further development of economic resources throughout the Commonwealth would facilitate such convertibility. It is gratifying to note that the Commonwealth countries are continuing their efforts towards this objective. The United Kingdom has announced a policy of partial convertibility of the sterling. It is hoped that the programme will succeed and lead to free convertibility of the sterling.

We have noted in the last chapter that latterly tariffs in India are assuming greater importance in their protective aspect from the point of view of developing industries. In 1949 the Government of India appointed the Fiscal Commission to go into the whole question of protection and assistance to Indian industries, and in January 1952 on the recommendation of the Fiscal Commission a permanent Tariff Commission was appointed. One of the most important terms of reference of the Tariff Commission was the consideration of protection to be granted to potential and nascent industries. The Commission was also to study broad questions of the effects of protection on prices, cost of living, etc. and to watch closely its repercussions. In granting protection to certain existing or potential industries the Commission also had the power to lay down standards, prices, technological conditions and output. In 1952-53 the Commission conducted inquiries into the automobile industry for the grant of protection and for determination of price of steel produced by the Steel Corporation of Bengal and the Tata Iron and Steel Company. As a result it recommended that the

assembling of parts should cease and the demand for vehicles should be concentrated on firms with a manufacturing programme. This was accepted by the Government. Similarly, on the recommendation of the Commission the Government decided in favour of the grant of an increase of Rs. 32 per ton in the retention prices of steel for the years 1953-54 and 1954-55. The same year it recommended protection to power and distribution transformers and flax goods. This too was accepted by the Government. In 1954-55 the Tariff Commission further suggested the extension of protection to industries producing component parts of automobiles such as automobile leaf springs, sparking plugs and automobile hand tyre inflators. Also from time to time it recommended protection to light engineering goods. It was realized that in course of time the country would become self-sufficient in automobiles and parts thereof and would be able to produce light engineering goods for export.

It may therefore be noted that, while efforts have been to expand exports of commodities in the nature of raw materials, at the same time fresh enquiry and research are being made to diversify the components of export trade.

CHAPTER V

INDIA'S ECONOMIC DEVELOPMENT DURING THE SECOND FIVE YEAR PLAN

WE have noted that planning for economic development in the First Five Year Plan was basically concerned with the problem of increasing production and incurring expenditure on overheads which were meant primarily to increase productive capacity of the economy from the point of view of long term economic development. The scheme of priority was also worked out according to the objective of laying foundation for an orderly development in future. The capital coefficient on which the main reliance was put for estimating the total expenditure in the public sector took into consideration the predominant role of agriculture. But as pointed out earlier—it was not realized that one of the inputs in agriculture was highly unreliable. In the first two years of the First Plan the magnitude of developmental expenditure was not high partly because it took some time for the people in general to realize the significance of economic planning in a democratic society, and also because of the outbreak of the Korean War which made it difficult to secure the goods needed from abroad. In the third year of the Plan, however, great attention was paid towards incurring expenditure and it was in the last two years that the expenditure was accelerated to an appreciable extent. We therefore find that the total expenditure incurred turned out to be much less than originally provided in the Plan. Table 10 gives the allocation and the outlay during the First Five Year Plan under major heads of development.

It will be noted that the total expenditure incurred in each one of the items fell short of the provision in the Plan. Yet over the whole plan period national income increased by about 17.5 per cent whereas it was expected to increase only by 11 per cent. The Planning Commission in its review of the First Five Year Plan pointed out

Despite the shortfalls in expenditure that have occurred under almost all heads, it must be emphasized that public develop-

mental expenditures have been stepped up to remarkably high levels and that in several vital fields like irrigation and power, agricultural improvement, railways and roads, the progress recorded is impressive¹

TABLE 10

ALLOCATION AND OUTLAY DURING THE FIRST FIVE YEAR PLAN

Item	Total plan provision (including adjustments)		Outlay during 1951-56	
	In crores of rupees	Per- centage	In crores of rupees	Per- centage
Agriculture and Community Development	354	14.9	299	14.8
Irrigation and Power	647	27.2	585	29.1
Industries and Mining	188	7.9	100	5.0
Transport and Communications	571	24.0	532	26.4
Social Services	532	22.4	423	21.0
Miscellaneous	86	3.6	74	3.7
Total	2,378	100.0	2,013	100.0

It was pointed out that agricultural production showed "striking improvement", the output of foodgrains in 1955-56 was 64.8 million tons being about 3 million tons above the target laid down in the Plan. The production in 1953-54 was 68.8 million tons. The output of cotton, jute and oilseeds also recorded substantial increase. Statement VIII gives a detailed account of the increases in agricultural production.

This was considered to be a sufficient improvement in agriculture so much so that in the Second Five Year Plan it was considered desirable to shift the priorities. As discussed later this became a great cause for the difficulties in the balance of payments during the first two years of the Second Plan.

The progress of industrial production must be viewed from the point of a mixed economy in which private sector was expected to play a considerable role. It was found that the progress of investment in the private sector was according to expectations, and the industrial production also increased steadily. Statement

¹ Government of India, Planning Commission, *Review of the First Five Year Plan*, May 1957, p. 3

IX shows the industry-wise increase of production in the industrial sector. The target of production for the mill-made cloth was exceeded by about 400 million yards. In the cases of sugar, sewing machines, paper and paper board and bicycles production reached the anticipated level, in fact in some cases the targets were surpassed. The availability of raw material and the utilization of excess capacity as well as fresh investments were responsible for this increase. It may be noted that the main emphasis by the private sector was on the light consumers' goods industries and therefore in the public sector emphasis was laid on heavy basic industries.

The important point to note is that heavy expenditure on agriculture and rehabilitation did not allow any great expenditure on building up of overheads. Although the total expenditure on overheads was sufficient for the economy to function during the First Plan period yet they could not spend enough to create conditions for future development of the economy. The Planning Commission has noted in the *Review of the First Five Year Plan* that initial provisions of the economic overheads were small in relation to the needs of a growing economy. The railways programme was merely a rehabilitation programme. The development of power was just sufficient to meet the increasing demand. On the development of mineral resources, ports and shipping, enough expenditure could not be incurred. The Second Five Year Plan, therefore, was basically designed to fill up the deficiencies in these respects, and in this way it can be considered a continuation of the First Plan.

Statement X shows the distribution of plan outlay in the First and the Second Five Year Plans. Table 11 summarizes Statement X and shows in what direction there has been change of priorities in the Second from the First Five Year Plan.

From a comparative study of the priorities of the First and Second Five Year Plans it becomes obvious that although there has been an increase in absolute amount in the case of all major heads of development the real increase has been in the case of industry and mining and transport and communications in which the expenditures are supposed to have increased by 397.2 per cent and 148.7 per cent respectively. It may, however, be noted that the very great increase of expenditure in industry and mining (almost fourfold) is due to the initial small

amount of expenditure under this head in the First Plan. On the other hand in absolute terms the highest figure in the Second Plan happens to be in the case of transport and communications. An analysis in regard to transport and communications shows that the highest increase has been in the case of Railways in which the amount of expenditure to be incurred has been increased from Rs 268 crores to Rs 900 crores. Similarly a further break up of the figures for industry and mining shows that the largest increase is envisaged in the case of mineral developments in which the expenditure has increased from Rs 1 crore in the First Plan to Rs 73 crores in the Second Plan. However, the increase of expenditure amounting to Rs 617 crores on industry and mining is basically for the development of large-scale industries.

TABLE II

**DISTRIBUTION OF PLAN OUTLAY IN THE FIRST
AND SECOND FIVE YEAR PLANS**

<i>Item</i>	<i>First Five Year Plan</i>		<i>Second Five Year Plan</i>		<i>Percentage of increase of 4 over 2</i>
	<i>Total provision (Rs crores)</i>	<i>Percentage</i>	<i>Total provision (Rs crores)</i>	<i>Percentage</i>	
1	2	3	4	5	6
Agriculture and Community Development	357	15.1	568	11.8	59.1
Irrigation	661	28.1	913	19.0	38.1
Industry and Mining	179	7.6	890	18.5	397.2
Transport and Communication	557	23.6	1385	28.9	148.7
Social Services	533	22.6	945	19.7	77.3
Miscellaneous	69	3.0	99	2.1	43.5
Total	2356	100.0	4800	100.0	

A similar conclusion can be arrived at by considering the distribution of Plan outlay from the points of view of the difference between real investment and current expenditure. Table 12 illustrates this point.

It is obvious from Table 12 that out of the Rs 4800 crores almost 80 per cent is for the real investment meant for building

TABLE 12
DISTRIBUTION OF PLAN OUTLAY
(in crores of rupees)

<i>Item</i>	<i>Total o tlay</i>	<i>In est ment outlay</i>	<i>Current outlay</i>
Agriculture and Community Development	568	338	230
Irrigation and Power	913	863	50
Industry and Mining	890	790	100
Transport and Communications	1 385	1 335	50
Social Services	945	455	490
Miscellaneous	99	19	80
Total	4 800	3 800	1 000

up of productive assets. The highest amount to be spent is in transport and communications. In the cases of irrigation and power, and mining and industry substantial amounts are to be spent for creating capital assets. A small percentage of increase in expenditure on irrigation and power appearing in the Second Plan over that of the First Plan is due to the initial larger expenditure on this item.

Statement XI shows the main targets of physical production and development of the First and the Second Five Year Plans. It also shows percentage increase of the Second Plan targets as compared to the First. It is obvious from this statement that the target of percentage increase of agricultural production was almost insignificant presumably because it was considered that food production had already increased sufficiently during the First Five Year Plan. It was surely a mistake to start with this assumption specially when it was known that the increased production in agriculture had taken place in spite of the short-fall in expenditure during the Plan. It should have been realized that perhaps the increased production was due to favourable monsoons which may not be repeated. On the other hand there was a great emphasis on increasing the targets of physical production in the case of mineral and large scale industry. In a country where the population at base was already very large and was on an increase the comparative neglect of agricultural production was bound to lead to difficulties in future. Moreover

it was not anticipated that there was possibility of an increased demand for agricultural produce because of the greater investments in mineral and large-scale industries which were bound to generate income

Greater attention to the diversification of the economy and consequently the changes made in the priorities also led to the revision of the industrial policy of 1948 and the new policy was declared on 30 April 1956, keeping in view the "socialistic pattern of society" of the Avadi Resolution and the Directive Principles of the Constitution of India. According to the Avadi Resolution it was decided to accelerate the rate of economic development in the industrial sector by developing heavy and machine-making industries, expanding the public sector and by building up a large growing cooperative private sector. The resolution specifically mentioned that the State will progressively assume a predominant and direct responsibility for setting up new industrial undertakings and for developing transport facilities. It will also undertake State trading on an increasing scale. At the same time, as an agency for planned national development in the context of the country's expanding economy, the private sector will have the opportunity to develop and expand. The principle of cooperation should be applied wherever possible for a steadily increasing proportion of the activities of the private sector to develop along cooperative lines. In consultation with the Planning Commission the Government of India drew two schedules, namely, Schedule A consisting of arms and ammunition, atomic energy, iron and steel heavy electrical plants, minerals, and communications and transport, and Schedule B, including machine tools, fertilizers synthetic rubber, etc. The government will have exclusive ownership and control of the industries mentioned in Schedule A and it will have increasing role to perform in those of Schedule B. Thus the whole lot of light consumer's goods industries have been left to the private sector. As a matter of fact India is committed to have a sort of mixed economy by combining the market mechanism with the planning technique. The State will play a predominantly greater role in establishing industrial undertakings of basic and strategic importance or in the nature of public utilities. Industries which require investment on a large scale and which are not profitable for the individual entrepreneurs to establish will also be taken up

by the Government. This will diminish, so to say, the difference between the *individual and social marginal productivities*, and would greatly facilitate the economic development based on the market exchange economy. We have noted our Prime Minister's statement in suggesting a greater decentralization with an overall supervision by the Government. Yet in this context it is surprising to note the specific mention in the resolution that the State will undertake state trading on an increasing scale. One possible advantage of state trading may be to check the inflationary pressure due to the generation of income and the shortages of consumers' goods in the developmental process of the economy. But for that the State does not have to adopt state trading on commodities like food, which however might be desirable in certain circumstances. Moreover it is better to adopt other monetary and fiscal measures to curb inflation, state trading may be adopted only when it is absolutely essential. Again it seems inconsistent to have state trading on an increasing scale on the one hand, and adopt a "policy of the State to facilitate and encourage" the development of a large number of industries, which are excluded from Schedule A and B, in the private sector. In the same policy announcement the private sector is also assured of encouragement by means of proper fiscal and other measures, and by fostering institutions to provide financial aid to private industrialists.

The policy aiming at the expansion of the public sector was not peculiar to the industrial field, rather it was a general policy adopted to be executed in implementing the Second Five Year Plan. Whereas in the First Five Year Plan the private sector was given an equally important role to perform, in the Second Plan its share was reduced to 31 per cent. Thus out of the total estimated investment of Rs 6,200 crores over the Second Plan period, Rs 4,800 crores were to be invested in the public sector.

To raise Rs 4,800 crores the Planning Commission had to calculate the income from budgetary resources at the existing and revised scale, non budgetary revenues from public enterprises, and the possibilities of mobilizing private savings to public investments through public borrowing. Thus the domestic resources available from savings were of the order of Rs 2,400 crores. Deficit financing was to be undertaken to the extent of Rs 1,200 crores. Thus a gap of Rs 1,200 crores was left to be

met by external assistance. The Planning Commission had envisaged aid from foreign sources to the extent of Rs. 800 crores leaving an uncovered gap of Rs. 400 crores.

The calculation of the need for raising external resources to the extent of Rs. 800 crores was based on the assumption that the terms of trade during the five years of the Second Plan would, on an average, remain the same as during 1955-56 and that the inflationary pressures will be held under firm control. On this assumption the total deficit in the balance of payments over the plan period was expected to be Rs. 1,100 crores. This deficit was to be offset to the extent of Rs. 200 crores by the release of our sterling balances. Further, the inflow of private foreign capital was assumed to be of the order of Rs. 100 crores. Thus a net amount of Rs. 800 crores was to be raised externally for meeting the deficit in the balance of payments. The foreign resources which were made available to India during the First Plan were not fully utilized and a balance of Rs. 193.36 crores was left to be used in the Second Plan. The rest was to be raised through loans from the IBRD and by loans and grants from other friendly foreign governments.

The amount of Rs. 800 crores expected from external sources during the Second Plan was very great—four times that expected during the First Plan—but the amount actually raised has been still greater. The total amount authorized upto the end of January 1959 was as much as Rs. 1,018.29 crores. Statements II A and II B give detailed description of the amounts authorized by various agencies and their utilization.

The International Bank for Reconstruction and Development has continued its lending operations to India on a more liberal scale. It sanctioned a loan of Rs. 11.90 crores in continuation of its two previous loans for the Damodar Valley Corporation, and another loan of Rs. 4.67 crores for the completion of Trombay Thermal Plant for the installation of which it had given one loan previously. Similarly a second loan of the amount of Rs. 9.52 crores was sanctioned for the expansion of the Indian Iron and Steel Company. For the programme of railway rehabilitation and expansion it advanced two more loans of Rs. 42.86 crores and Rs. 40.48 crores.

Among the new borrowers taking fresh loans from the IBRD are the Air India International, Calcutta and Madras Port

Authorities and the Tata Iron and Steel Company The loan of Rs 2 67 crores at the rate of 5½ per cent to the Air India International is a part of the joint financing as along with it the Air India International has also borrowed \$11 2 million from five leading US commercial banks These funds will enable the All to purchase jet passenger airplanes and ancillary equipment The Bank granted a 20 year loan of Rs 13 81 crores at 5½ per cent to the Commissioners for the Port of Calcutta for the purpose of rehabilitation and improvement of the Port and for providing other facilities so as to relieve ship congestion and expedite handling of cargo Similarly Madras Port has secured a loan of Rs 6 67 crores on the same terms as Calcutta Port It would be used for modernization and expansion of the port to increase its capacity to handle greater traffic The Tata Iron and Steel Company has taken two loans of Rs 35 71 crores and Rs 15 47 crores to complete its two expansion programmes by the end of 1960 These programmes will enable the Company to produce a substantially greater amount of steel at the lowest cost of production in the world This will help India's Second Plan to materialize its objective of bringing domestic output of steel abreast of demand by the end of March 1961 Thus the total amount of loans sanctioned during the Second Plan by the World Bank stand at Rs 183 76 crores all of which are on a long term basis

Loans coming from friendly foreign governments amounted to Rs 255 70 crores since the beginning of the Second Plan As compared to the First Plan period a greater number of foreign governments have adopted a sympathetic and cooperative attitude and loans have been made available by various countries such as USSR, UK, West Germany, Japan, and Canada The reason might be that these governments are confident of the progress of India's economic development The USSR has given credit for industrial development of the amount of Rs 59 50 crores besides the previous credit for the Bhilai Steel plant of Rs 63 07 crores which is being spent during the Second Plan The United Kingdom has made available two credits through the Export Credit Guarantee Department, the credit for Durgapur plant amounts to Rs 20 00 crores and that for the import of capital goods amounts to Rs 38 10 crores On similar lines the West German Government has offered two credits—one of Rs 74 83 crores for Rourkela Steel plant and the other of

Rs 19.94 crores for the import of capital goods. Yen credit from Japan amounts to Rs 23.81 crores and another loan from Japan is for the iron ore project. The two Canadian wheat loans amount to Rs 15.71 crores for meeting the food shortage since the beginning of the Plan.

Assistance from the United States has been coming from varied sources and in various forms. Loans from the United States to be repaid in dollars amounted to Rs 92.09 crores. These came in the form of a loan from a US bank to the Air India International amounting to Rs 5.33 crores, Lazard Brothers' credit of Rs 15.33 crores to meet a part of the cost of the Durgapur Steel Plant, and the Export Import Bank loan of Rs 71.43 crores.

The United States has realized India's difficulty in raising dollar resources for the servicing and repayment of loans and therefore has given loans worth Rs 115.48 crores to be repaid in rupees, namely, the loan under TCA Programme of the amount of Rs 22.63 crores, two loans from US Development Loan Fund amounting to Rs 83.33 crores and the US Government loan for Orissa Iron Ore Project of Rs 9.52 crores. These loans will not have any strenuous effect on India's balance of payments.

PL 480 assistance from the United States between August 1956 and September 1958 has been of Rs 270.67 crores. The sale proceeds of the PL 480 assistance are to be divided in three parts—the first part to be used by the US Government in India, the second part by the State Governments and the third part to be utilized for advancing mutually agreeable loans to US and Indian firms.

The grants made to India by January 1959 amounted to Rs 100.59 crores. Comparatively speaking they are considerably less than those of the First Plan. Whereas they were nearly 40 per cent of the total foreign assistance in the First Plan, during the Second Plan they are hardly 10 per cent of the total foreign assistance. The grants during the Second Plan have come under the Technical Cooperation Administration (Rs 12.23 crores), from US Public Law 480 (Rs 42.75 crores), Colombo Plan (Rs 41.55 crores) and from the Ford Foundation (Rs 7.31 crores).

All in all the US and the IBRD continue to be the major sources of external assistance though other governments have also extended their friendly cooperation to a considerable extent.

It will be noted that the World Bank has given loans for purposes of the development of power plants, means of transport and communications and the manufacture of Iron and Steel. We have noted that the expenditure on the development of the railways during the First Plan was in the nature of rehabilitation and therefore greater expenditure on building up of the capacity of the railways was needed for the industrial expansion of the country. The development of aviation, shipping and ports is necessary for the expansion of international trade relations, for which loans were made available by the IBRD. Loans for the development of industry and agriculture came forth not only from the IBRD but also from other friendly governments. Foreign governments also provided loans for the import of capital goods and general economic development. It is therefore obvious that while in the First Plan a ground was prepared for a more balanced economic development with certain limitations, a greater emphasis was laid during the Second Plan on building up of overheads, the means of transport and communications and the development of basic industries. Thus the tempo of economic growth, the interdependence of accelerated economic development and the balance of payments difficulties can hardly be over-emphasized. Over and above that the basic mistake of not providing enough of essential consumers' goods especially food was committed which, as we shall see, led to the difficulties of foreign exchange in spite of a large amount of foreign assistance being available.

TABLE 13
FOREIGN EXCHANGE REQUIREMENTS OF VARIOUS
PROJECTS
(in crores of rupees)

Item	First Five Year Plan	Second Five Year Plan
Power	260	440
Railways	268	1 125
Industries in public sector	57	524
Industries in private sector	233	575
Total	818	2 664

As we have noted, total investment during the Second Plan

was two times that during the First Plan. The Second Plan however differed not only from the point of view of magnitude but also from that of structure. Table 13 gives a rough calculation of the foreign exchange requirements of the various projects during the First and Second Plans.

According to Table 13¹ the required foreign exchange is more than three times as much as in the First Plan. Even this was an under estimation because actually there was a greater shift in favour of the projects requiring larger proportion of foreign exchange due to the great emphasis on heavy industries which required larger imports of capital goods.

Statement XII shows India's overall position during the first three years of the Second Five Year Plan. It will be noted that whereas the balance of payments situation during the First Five Year Plan was on the whole well under control it shows a net deficit of the order of Rs. 221 crores in the first year of the Second Five Year Plan. This deficit stands in sharp contrast to the surplus of Rs. 15 crores during the year 1955-56 the last year of the First Five Year Plan. The high magnitude of the deficit in the balance of payments in the year 1956-57 was due to a number of reasons. First the high tempo of developmental activities in the public sector specially in the industrial programme led to a considerable increase in the imports on Government account. Moreover the import contents of some of the developmental projects for instance iron and steel were under estimated and the actual imports far exceeded the anticipated ones. Secondly the imports of foodgrains increased to Rs. 102 crores in 1956-57 as compared to only Rs. 20 crores in the previous year. This combined with the greater imports of capital goods on Government account led to the doubling of the imports in the public sector the imports rose to Rs. 291 crores in 1956-57 as compared to Rs. 138 crores in 1955-56. Lastly the optimistic expectations which resulted from the increased developmental expenditure in the public sector led to unexpectedly great economic activity in the private sector. This combined with the liberalized import policy in the past resulted in a substantial increase in the imports on private accounts. The total imports therefore showed an increase of Rs. 346 crores over the previous year. Exports on the other hand diminished slightly i.e. from Rs. 641

¹ Cf. *Reserve Bank of India Bulletin* July 1957 p. 642.

crores in 1955-56 to Rs 635 crores in 1956-57. The diminution of exports was mainly due to cotton and vegetable oils which happen to be important commodities of exports.

In 1957-58 the adverse balance of payments still accentuated and it was of the order of Rs 260 crores as compared to that of Rs 221 crores in 1956-57. The increase in imports was mainly due to Government account where the imports increased by more than 70 per cent i.e. from Rs 291 crores in 1956-57 to Rs 509 crores in 1957-58. This phenomenal increase of imports on Government account was mainly due to increased imports of foodgrains, which rose from Rs 102 crores in 1956-57 to Rs 152 crores in 1957-58, and due to greater imports of machinery, equipment, iron and steel and defence stores. The imports on the private account, on the other hand, were considerably reduced by means of rigorous control over imports specially of non-essential commodities. Yet imports of machinery and raw materials by the private industrialists increased over that of the previous year. Part of the increased figures can be accounted by the past commitments for which payment was made in 1957-58. On the side of exports, in spite of the various incentives which were provided, they decreased by about Rs 40 crores from the previous year. The main reason for the fall in exports was due to the recession in the United States which resulted in a setback to economic activity all over the free world.

The serious condition in regard to the foreign balance of payments situation (which was mainly due to the short fall in the food production, initial under-estimation of the foreign exchange components of certain projects and the inclusion of a number of schemes which appeared urgent at later stages) combined with the rising prices of commodities, specially of foodgrains, in the country led to the rise in the cost of the Plan considerably. For instance, it was found that because of the rise in general prices the cost of the Plan had increased by Rs 470 crores, under-estimation of the cost of some projects accounted for an increase of Rs 285 crores and the inclusion of new schemes which appeared to be urgent at later stages further increased the cost by Rs. 195 crores. Thus it was found that to achieve the same physical targets the original Plan of Rs 4,800 crores would in financial terms have cost Rs 5,750 crores. The Planning Commission, therefore, in their memorandum on the Appraisal and

Prospects of the Second Five Year Plan submitted to the National Development Council and the Parliament in May 1958, suggested that if despite the increased cost the Plan was to be kept at Rs 4 800 crores then, the allocation of the expenses would have to be revised. The revisions suggested are shown in Table 14

TABLE 14
REVISIONS IN EXPENDITURE SUGGESTED BY THE
PLANNING COMMISSION

	<i>Original</i>		<i>Revised</i>	
	<i>Expenditure (in crores of rupees)</i>	<i>Percentage of total</i>	<i>Expenditure (in crores of rupees)</i>	<i>Percentage of total</i>
1 Agriculture and Community Development	568	11.8	568	11.8
2 Irrigation and Power	913	19.0	860	17.9
3 Village and Small Industries	200	4.2	200	4.2
4 Industries and Minerals	690	14.4	880	18.4
5 Transport and Communications	1 385	28.9	1 345	28.0
6 Social Services	945	19.7	863	18.0
7 Miscellaneous	99	2.0	84	1.7
Total	4 800	100.0	4 800	100.0

It is to be noted that the financial plan of Rs 4 800 crores would have meant a reduction of 13 per cent in the physical targets which were to be achieved originally. But since the resources were not sufficient to maintain the original Plan expenditure of Rs 4 800 crores it was considered by the Planning Commission to reduce the expenditure of the Plan by Rs 300 crores thus bringing it down to the level of Rs 4 500 crores. The reduced outlay of the Plan to the level of Rs 4 500 crores was to mean allocations as indicated in Table 15.

The revised figures as given in Table 15 indicate that there is no difference whatsoever in the priorities in the allocation of the resources. It would however mean a reduction in terms of physical targets of almost 19 per cent from the original plan.

The National Development Council and the Parliament gave due consideration to the revised scheme submitted by the Planning Commission but it was generally realized that while on the

TABLE 15
ALLOCATIONS BASED ON THE REDUCED OUTLAY
OF THE PLAN

<i>Item</i>	<i>Original</i>		<i>Revised</i>	
	<i>Expenditure (in crores of rupees)</i>	<i>Percentage of total</i>	<i>Expenditure (in crores of rupees)</i>	<i>Percentage of total</i>
1 Agriculture and Community Development	568	11.8	510	11.3
2 Irrigation and Power	913	19.0	820	18.2
3 Village and Small Industries	200	4.2	160	3.6
4 Industries and Minerals	690	14.4	790	17.5
5 Transport and Communications	1 385	28.9	1 340	29.8
6 Social Services	945	19.7	810	18.0
7 Miscellaneous	99	2.0	70	1.6
Total	4 800	100.0	4 500	100.0

one hand it was not possible to keep the original plan of Rs 4,800 crores as the real resources fell short of the requirements, on the other hand a reduction of the plan by Rs 300 crores would have a demoralizing effect on the public at large. The National Development Council therefore decided to bifurcate the Plan. Part A of the Plan costing Rs 4,500 crores was to include projects relating to agricultural production, "core" projects and the projects which had reached an advanced stage and other essential schemes. The remaining part of the plan that is Part B was to consist of the rest of the schemes which could be undertaken if the resources were available.

Since then emphasis has been on the achievement of Part A of the Plan and it has naturally reduced the previous strain on the economy. Even then imports of the public sector have continued to increase although the rate of increase has been much slower than before. In 1958-59 for the first time imports on Government account have been more than half of the total imports. The slow rate of increase of imports is however due to the effects of the Government's policy to limit imports of non-essential goods to the minimum. Imports of foodgrains continued to be an important item although they were lower by Rs 10 crores than in the

previous year. Imports on the private account on the other hand were very greatly curtailed especially in the case of goods which were wholly or mainly manufactured. The total imports on private account fell by 27 per cent. In view of this fall in imports in the private sector it is interesting to note that imports of raw materials were higher than in the previous year because the Government wanted to encourage industries in the private sector.

It is however disquietening to note that in 1958-59 exports further declined even though the Government had established for purposes of export promotion certain institutions like the State Trading Corporation, the Exports Risks Insurance Corporation and the Directorate of Export Promotion. The reasons for the decline in exports were several. Firstly there was the impact of the recession in the United States on the Western countries which led to the curtailment of their imports. Secondly, growing competition with Japan and China in the South-east Asian markets regarding cotton textile goods diminished India's exports. Lastly the restrictive import policy of the Government led to domestic utilization of a substantial quantity of raw materials formerly exported which in turn reduced their exports. Thus the total deficit trade balance in 1958-59 was Rs. 470 crores which was higher than in 1956-57. The fact that it was lower than that of 1957-58 was entirely due to the severe curtailment of private imports. Happily during this year we received a very substantial financial assistance (as much as Rs. 217 crores) which has diminished the strain on foreign exchange to Rs. 47 crores as compared to that of Rs. 260 crores in 1957-58 and that of Rs. 221 crores in 1956-57. The easing of the situation thus has been entirely due to the restrictive policy of imports on private account and very great external assistance.

These facts reveal that in the first instance the food situation in the country remains serious and every year we have been using a substantial amount of foreign exchange for the imports of foodgrain. The fact that a substantial part of these food imports comes under PL 480 does not mean any real solution of the problem as this increases the debt burden on the country. Again the news that Australia and Canada want to export what they call their normal exportable wheat to India of the magnitude of 400 000 to 500 000 tons every year (and the US Government

is going to reduce the export of US farm surpluses to that extent) means another burden to the country. The interesting feature of this situation is that the Government of India is willing to enter into a barter deal to avoid the foreign exchange problem. Knowing that the country has not been in a position to increase exports to any great extent it sounds like a paradox to negotiate a barter deal for the imports of foodgrains. Our Food Minister has mentioned once again the necessity of building a buffer stock of five million tons from the importation of foodgrains under PL 480 programme from the United States. All this shows the necessity for the improvement of agricultural sector for which short-term measures are really no substitutes. As we have emphasized earlier the real problem of the development of underdeveloped countries is the development of both agriculture and industry. We would be committing a great mistake if we do not pay due attention to the development of agricultural production and neglect allied problems like land reforms, etc. It may also be mentioned that we have been attempting to get over our difficulties by means of foreign loans and assistance which means greater difficulties of foreign exchange in near future as soon as repayment on a large scale starts. It is therefore necessary that greater attention should be diverted to the encouragement of inflow of private capital which means obviously less difficulties and greater advantages in the process of economic development of the country.

One important thing to note is that during the three years of the Second Five Year Plan our policy in relation to international trade has been that of restriction on the import of luxury consumer goods and the efforts to promote exports as far as possible. This was with a view to lessening foreign exchange difficulties which are necessarily involved in developmental process. In 1956-57, for instance, with the initiation of large-scale developmental programmes imports of raw materials in the first half of the year were liberalized. That led to optimistic expectations on the part of private entrepreneurs, and the expansion of the public as well as the private sectors combined with food shortage made the foreign exchange requirements far more than anticipated. Consequently in the later half of the year a restrictive import policy was pursued in regard to luxury consumer goods and even raw materials and machinery on private account. However, in spite of the acute difficulties as regards

foreign exchange resources the exporters of various manufactured commodities in the country were encouraged to import machinery and raw materials required for the manufacture of exportable commodities. To promote exports of commodities like mica, leather and leather goods, Export Promotion Councils were set up. Moreover, for exploring and supplementing the existing channels of trade the State Trading Corporation was set up. All this was meant to increase exports over imports to enable the country to abridge the balance of payments difficulties.

In the year which followed, foreign exchange difficulties were accentuated and it became necessary to follow a policy of drastic cuts in the imports of non-essential consumer goods. But even at the time when it appeared that there was a sort of crisis of foreign exchange (which ultimately led to the rephrasing of the Plan) adequate provision was made for the import of essential basic materials so that developmental activities might not be retarded. Thus, although private imports were restricted considerably, the increased imports on Government account more than compensated the reduction on private account.

Keeping in view the acute foreign exchange difficulties, the Government of India appointed the Export Promotion Committee in the beginning of 1957, which submitted its report in August 1957. The Committee recommended reduction of export duty on tea, curtailment of consumption of certain commodities like groundnut oil and negotiations of barter trade agreements. In the same year a Directorate of Export Promotion was also established to coordinate the activities of the Export Promotion Councils. In addition, the Export Risks Insurance Corporation was also set up to facilitate exports.

This policy of export promotion was continued in the year 1958-59 and in the case of a number of commodities, e.g. cotton and jute textiles, electrical goods, etc. control on exports was released and large export quotas were granted for raw cotton, groundnuts, tea etc. A number of fiscal concessions were also granted to the manufacturers of exportable commodities so that Indian goods might be sold at competitive prices in foreign markets.

The import policy was very restrictive specially during the first half of the year. In the second half of the year, however, a great scarcity of some of the consumer goods like infant food,

watches and photographic goods was felt and therefore import policy in regard to these goods was liberalized to a certain extent. Yet during the whole of the year the need of exports was always kept in view, and a policy of *linking up* of exports with imports of materials and machinery was pursued. The activities of the various institutions established for the purpose of export promotion were greatly intensified but even then exports could not be increased to any significant extent.

Thus we find that in spite of the vigorous efforts made by the Government to promote exports and restrict imports of luxury consumer goods there has been a deficit in the balance of trade during all the three years of the Second Five Year Plan. In the third year, however, the deficit was reduced, but that was mainly on account of the large inflow of foreign assistance in the form of loans and grants.

The situation may be further analysed by considering the position of the deficit balance of payments in regard to the various major currency groups. Statement XIII shows the region-wise summary of India's balance of payments on current account for 1956-57 to 1958-59. In 1956-57 the deficit was spread over all the currency groups but it was mainly concentrated in regard to the OEEC countries. The imports from all the groups increased but the largest increase was from the OEEC countries. Because of the increased competitiveness of the various countries of this group the export prices of their commodities were considerably low. This, combined with the fact that the area is capable of supplying us the goods needed for the developmental programmes accounts for the large increase of imports from this region. The large deficit of trade balance with the sterling and the dollar areas is to a considerable extent made up by invisibles and official donations.

In the following year, 1957-58, the deficit was accentuated. As we have pointed out earlier a substantial increase from the dollar area was largely due to the imports of foodgrains under the Technical Cooperation Administration and PL 480 programmes. Exports to the dollar area were increased to a considerable extent. *This combined with a substantial amount of official donations and invisibles led to a slight diminution in the overall current deficit balance of payments from the dollar area.* On the other hand in regard to the sterling area although imports dimi-

nished slightly yet the diminution in exports more than counter-balanced the increase and the trade balance in 1957-58 was actually more than that of 1956-57. The deficit was very much pronounced in the case of OEEC countries where both increase in imports and decrease in exports simultaneously took place. Since official donations and invisibles from this area are insignificant the deficit in the trade balance was Rs. 241 crores as against Rs. 200 crores in the previous year.

In 1958-59 there was a narrowing down of the deficit with respect to all the areas—the greatest being in the case of the OEEC countries. This is due to the substantial reduction in imports from all these areas specially on private accounts. The narrowing down of the overall deficit has also been made possible by the great inflow of foreign grants and assistance during this year.

A very disquieting feature of the whole situation was whereas there used to be a surplus with the rest of the non sterling area during the First Five Year Plan, during the first three years of the Second Five Year Plan it turned into a deficit which has been on continuous increase. This is as we have noted earlier due to the greater competition with the cheap products from China and Japan in the Middle East and Far East. The negotiations for the formation of European Free Trade Association (which is almost taken for granted to start from July 1960) has increased India's fear about its adverse effect on exports. However, the assurance given by the British Chancellor of Exchequer in the Commonwealth Finance Ministers' Conference to the Commonwealth countries that their interests will be safeguarded is quite encouraging.

All in all we note that in spite of the rephrasing of the Second Five Year Plan we have not been in a position to overcome the difficulties of deficit balance of payments. An analysis of the total deficit shows that the difficulties have been mainly because of the high tempo of developmental activities in the public sector and the acute shortage of foodgrains. A greater attention has got to be paid for the development of consumer goods industries and production of raw materials which are the responsibility of the private sector. After all in the earlier stages of economic development we have to increase our exportable surplus to make possible large imports of capital goods required for develop-

mental process. And this can be done only by providing greater incentives to private capitalists who can expand the consumer goods industries.

Happily the Government of India has not neglected this aspect altogether. We have noted in the last chapter the initiative it took in the establishment of the Industrial Finance Corporation of India and the State Industrial Finance Corporations and the loan assistance which it provided to the Industrial Credit and Investment Corporation of India for pumping capital into the private investment sector. These institutions have been successful in attracting internal private capital into the industrial field. These Corporations have increasingly raised funds in the Indian capital market. They have also sanctioned and disbursed increasing amounts of loans for the expansion of existing industrial concerns and for the establishment of new ones. It will not be out of place to discuss their activities in detail.

The Industrial Finance Corporation of India's disbursements of loans have been increasing in amount and the borrowing industries have become diverse in nature. Upto March 1959 it had sanctioned loans amounting to Rs. 64.34 crores. Though the amount of actual loans sanctioned in 1956-57 was less (Rs. 9.76 crores) than in the previous year (Rs. 13.38 crores) the amount of actual disbursement was significantly higher and stood at Rs. 24.10 crores. This amount was one third of the total disbursements made by the Corporation since its inception in 1948. Such a heavy disbursement of loans was partly due to the unpreparedness of the projects for which the loans were sanctioned, and it partly explains the fast tempo of industrial expansion in the private field with the beginning of the Second Five Year Plan. The Government of India, realizing the heavy pressure of demand for financial assistance from industrial concerns, gave a loan of Rs. 13.5 crores to the Corporation under the Second Five Year Plan. This amount was later raised to Rs. 22.5 crores.

During the next two years, 1957-58 and 1958-59, the loans sanctioned amounted to Rs. 9.06 crores and Rs. 6.91 crores respectively. Thus the amounts sanctioned have been showing a downward trend since the beginning of the Second Five Year Plan. Nevertheless, interestingly enough the actual disbursements to meet the past commitments of loans have been increasing every year so much so that 60 per cent of the total disburse-

ments by the Corporation since 1948 were during these three years of the Second Plan. The principal borrowers were co-operative sugar factories, chemical, cotton textiles, engineering and cement companies.

The amendment of the Industrial Finance Corporation Act in 1957 enabled the Corporation to raise funds to a greater extent to cope with the requirements of the borrowers. For example it can now float loans in the market upto ten times its paid up capital as against five times which it could do formerly. Of course it continues to have its borrowing privileges with the Reserve Bank of India. One important amendment which widens the scope of activities of the Corporation is that it has been empowered to guarantee deferred payments by importers of capital goods. This indeed is a major improvement in view of the need for importation of capital goods without at the same time having adequate exchange facilities to make payments on the spot.

The State Financial Corporations have been making steady progress in matters of sanctioning and disbursing of loans. Their activities during the last few years are indicated in Table 16.

TABLE 16

**LOANS SANCTIONED AND DISBURSED BY THE
STATE FINANCIAL CORPORATIONS**
(in crores of rupees)

<i>Year</i>	<i>Amount of loans sanctioned</i>	<i>Amount of loans disbursed</i>
1955-56	4.50	1.87
1956-57	4.43	2.86
1957-58	4.77	3.71
1958-59	4.99	3.33

Though the extent of the activities of these Corporations is limited yet they are performing a useful function in providing capital to medium-size industries. These Corporations act as agents of the State Governments in providing concessional finance to smaller industries.

They have gained confidence and stronghold in the capital market and have been issuing since 1957 bonds of ten years' maturities which were oversubscribed by the public. Thus they

are effectively channellizing the scattered capital towards smaller industries

The Industrial Credit and Investment Corporation of India was not very active during 1956-57 and did not utilize the \$10 million loan which the IBRD had sanctioned to it during the year. It was only in 1957-58 that it started sanctioning loans in foreign currencies and during the year it withdrew \$4.5 million from the loan taken from the IBRD. The delay in the utilization of the IBRD loan was inevitable because the IBRD does not disburse loans unless it thoroughly examines the projects for which the loan is given. The preparation and presentation of plans for such projects naturally takes time. The Corporation continued promoting expansion in investment activities by giving financial assistance in Indian as well as foreign currencies and by investing in shares and debentures and in underwriting operations. The total financial assistance which the Corporation had agreed to make available since its establishment in 1955 upto 1958 amounted to Rs 13.37 crores. Because of the increased pressure of demand for loans in foreign currencies the Corporation has sought to increase its dollar resources by obtaining another loan of \$10 million from the IBRD. The Government of India entered into an agreement with the US Technical Cooperation Mission in May 1959 to give a loan of Rs 10 crores to the Corporation out of the new PL 480 funds. This would increase the rupee resources of the Corporation.

The lending operations of the Industrial Credit and Investment Corporation of India Ltd. are broadbased, the borrowers being the paper, chemical, pharmaceutical, engineering, sugar, rubber, textile, cement, automobile, and electrical goods industries.

On 5 July 1958, a new Corporation under the name of Re-finance Corporation for Industry Private Ltd. was registered under the Indian Companies Act. The Corporation has been set up with the objective of providing relending facilities to medium sized industries against the medium term loans granted to them by banks. The Corporation is meant primarily to encourage production in industries included in the Second Plan and in those to be included in the following Plans for India's economic development.

So far the Corporations had taken up only one aspect of

industrial development, that is, the provision of capital in the form of loans or investment in shares in the existing and newly established concerns. However, the Government has realized the need for controlling the direction of investment so that only the planned industries are established and expanded and as a consequence industrial development as a whole fits into the pattern of the national Plans. This of course, is badly needed in view of the fact that private investment if left to itself tends to be lopsided and there is likelihood that private investors might concentrate attention only on immediately profitable industries to the neglect of such industries which are important from the stand point of the development of the economy as a whole without undue reliance on the imports. In view of this the Government set up the National Industrial Development Corporation as a private limited company in the year 1954. The Corporation concentrates on projects relating to the manufacture of industrial machinery, production of primary intermediates required by drugs, dyestuffs and plastics industries, and some important raw materials like aluminium, synthetic rubber, etc.

The Corporation has specially taken up the task of the modernization of jute and cotton textile industries. It acts as an agency of the Government in the matter of advancing loans. In June 1959, with a view to speeding up the modernization process, the Corporation undertook the task of providing Indian made machinery on hire purchase basis to cotton and jute mills.

In Chapter I we have mentioned that the Second Five Year Plan was based on the Mahalanobis model of economic growth. Accordingly the rapid mechanization of the key industries was to be accompanied by decentralization of a number of small-scale industries which could provide increasing employment. This increased employment in small industries would to a certain extent, compensate the displacement of labour in the large-scale industrial sector. The Government of India in its effort to assist small industries provided financial assistance to State Governments to help the development of small industries during the First Five Year Plan and established the National Small Industries Corporation in February 1955. The activities of the Corporation have been intensified with the beginning of the Second Plan. It has extended the scope of its activities by (in addition to providing finance) supplying machinery to small

scale industries on hire purchase basis. In 1957 four subsidiaries of the Corporation were set up in Bombay, Calcutta, Madras and Delhi. The Corporation's activities are financed by grants and loans made by the Central Government.

The State Bank of India has been taking keen interest in the provision of finance to small industries. Since 1955 it has started "pilot" schemes for coordinated provision of credit to small industries at a number of centres throughout the country for the establishment of "industrial estates". For this purpose it follows a "Liberalized Credit Scheme".

Thus we find that private industrial sector is being provided on an increasingly large scale its capital requirements for the development of large as well as small industries. It is being realized that whatever discourages private capital inside the country also discourages the inflow of capital from outside. The Government of India is now conscious more than ever of the necessity of attracting foreign investments in India provided these investments be in conformity with the pattern of the national plans. In a recent note to the United Nations on India's economic progress it has been laid down "For development to continue at a satisfactory rate there will be need for a substantial flow of international capital for a long period to come". We are also going to pass legislation to indemnify foreign Governments (such as USA) who give guarantee to their nationals against expropriation in respect of their investments in India.

The encouragement to private foreign investors has become still more necessary in view of the recent policy announcements of the US Government to link US loans with purchases in the USA. The US was compelled to announce this policy because of the depletion of its resources in recent years. This is going to affect US assistance to India considerably.

We noted in the last chapter that the most appropriate type of business enterprise which contains the advantages of both private foreign capital and internal control is the combined venture in which both foreign investors and Indian capitalists participate. Many such schemes have been accepted during the Second Five Year Plan. For instance, a US firm and the Birlas are going to establish a big cement factory in India. Some Indian firms are combining with foreign firms in the production of diesel locomotives in India. For instance, TELCO will combine with a

German firm, National Engineering Industries of Jaipur with Hindustan Motors and the West German firm Mak, and the Texmaco, Calcutta with the American Loco Company to produce diesel locomotives in India. We hope in future many more negotiations of this sort will be undertaken to ensure smooth development of the country.

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STATEMENT I

NATIONAL INCOME OF THE INDIAN UNION, 1948-49 (by industrial origin)

<i>Item</i>	<i>Net output (in crores of rupees)</i>	<i>Percent- age</i>	<i>Number of persons engaged (in lakhs)^a</i>	<i>Net output per person engaged (thousands of rupees)</i>
<i>Agriculture</i>				
Agriculture, animal husbandry & ancillary activities ^b	4 070	46.7		
Forestry	60	0.7		
Fishery	20	0.2	905	0.5
TOTAL OF AGRICULTURE	4 150	47.6		
<i>Mining, Manufacturing, and Hand Trades</i>				
Mining	60	0.7	38	1.7
Factory establishments	580	6.6	149	0.6
Small enterprises	860	9.9		
TOTAL OF MINING, MANUFACTURING AND HAND TRADE	1,500	17.2	187	0.8
<i>Commerce, Transport and Communication</i>				
Communications (post, telegraph and telephone)	30	0.3	12	1.9
Railways	200	2.3		
Organized banking and insurance	50	0.6	95	1.5
Other commerce and transport	1,420	16.3		
TOTAL OF COMMERCE, TRANSPORT AND COMMUNICATION ^c	1,700	19.5	107	1.6
<i>Other Services</i>				
Professions and liberal arts	320	3.7	50	0.6
Governmental services (administration)	460	5.3	36	1.3
Domestic services	150	1.7	42	0.4
House property	450	5.2		
TOTAL OF OTHER SERVICES	1,380	15.9	128	1.1
NET DOMESTIC PRODUCT AT FACTOR COST	8,730	100.2	1,327	0.66
NET EARNED INCOME FROM ABROAD	—(20)	—0.2		
NET NATIONAL OUTPUT AT FACTOR COST NATIONAL INCOME	8,710	100.0		

^a Comprising principal earners including working dependants but excluding subsidiary workers

^b These include processing, marketing and ancillary activities performed by the cultivator in respect of his own product

^c Include services of indigenous moneylenders

STATEMENT II A
EXTERNAL ASSISTANCE, AUTHORISED AND UTILIZED
(in crores of rupees)

Details of assistance	A Loans and credits to be repaid in foreign currencies								
	Aid authorized before 1st Plan	Aid authorized during 1st Plan	Utilization upto the end of 1st Plan	Balance available for utilization during 2nd Plan	Aid authorized from 1-4 56 to 31-1 59	Total available for utilization during 2nd Plan	Estimated utilization from 1-4 56 to 30 9-58	Balance available for utilization	
1	2	3	4	5	6	7	8	9	
1 IBRD									
1 Railways-I	15 61		15 61						
2 Agriculture	3 43		3 43						
3 DVC-I	7 96		7 96						
4 DVC-II		5 00	1 96	3 04		3 04	3 04	11 90	
5 DVC-III									
6 All (Air India International)									
7 Railways-II						2 67	1 61	1 06	
8 Railways-III						42 86	39 35	3 51	
9 Calcutta Port						40 48		40 48	
10 Madras Port						13 81		13 81	
11 IISCO-I						8 67		6 67	
12 Trombay-I	14 29		2 78	11 51		11 51	8 12	3 39	
13 ICI	6 64		2 09	4 55		4 55	3 94	0 61	
14 TISCO-I	4 76			4 76		4 76	0 26	4 50	
15 TISCO-II					(a+)35 71	35 71	35 71		
					— 9 52	9 52	5 72	3 80	

(Contd.)

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STATEMENT II A

	1	2	3	4	5	6	7	8	9
16 Trombay—II						—4 67	4 67	1 97	2 70
17 TISCO—II						(b) 15 47	15 47	9 84	5 63
TOTAL		27 00	30 69	33 83	23 86	183 76	207 62	109 56	98 06
II Loans from foreign Govern- ments			90 31	90 31	63 07		63 07	34 44	28 63
1 US Wheat Loan									
2 USSR credit for Bhilai Steel Plant			63 07			59 50	59 50	0 11	59 39
3 USSR credit for Indus trial Development						20 00	20 00	8 00	12 00
4 ECGD credit for Durgapur plant from UK									
5 ECGD credit (for import of capital goods) from UK Government						38 10	38 10		38 10
6 West German credit (for Rourkela Steel Plant)						74 83	74 83	29 31	45 52
7 West German credit (for imports of capital goods)						19 94	19 94		19 94
8 Yen credit from Japan						23 81	23 81		23 81
9 Loan from Japan (for iron ore project)						3 81	3 81		3 81
10 Canadian Wheat Loan I						11 52	11 52	11 52	4 19
11 Canadian Wheat Loan II						4 19	4 19		
TOTAL			153 38	90 31	63 07	255 70	318 77	83 38	235 39

STATEMENT II B

Details of assistance	1	2	3	4	5	6	7	8	9
			Aid authorized during 1st Plan	Utilization upto the end of 1st Plan	Balance available for utilization during 2nd Plan	Aid authorized from 1-4 56 to 31 1 59	Total available for utilization during 2nd Plan	Estimated utilization from 1 4 56 to 30 9 58	Balance available for utilization
III Other Loans									
1 U S Bank Loan to AIR						5 33	5 33	.	5 33
2 Lazard Bros credit for Durgapur steel plant						15 33 71 43	15 33 71 43	5 33	10 00 71 43
3 Export-Import Bank of USA						92 09 531 55	92 09 618 48	5 33 198 27	86 76 420 21
TOTAL A		27 00	184 07	124 14	86 93				
B Loans and Credits to be repaid in Rupees									
1 Loan under T C A Programme			39 28		39 28	22 63	61 91	35 42	26 49
2 U S DLF Loan I						35 71	35 71		35 71
3 U S DLF Loan II						47 62	47 62		47 62
4 U S Government Loan for Orissa Iron Ore Project						9 52	9 52		
TOTAL B			39 28		39 28	115 48	154 76	35 42	-9 52 119 34
D Grants									
1 T C A			102 54	58 91	43 63	12 23	55 86	44 02	11 84
2 PL 480									
(i) August 1956									
(ii) September 1958									
3 Colombo Plan			46 19	25 92	20 27	25 71	25 71	19 32	6 39
4 Ford Foundation			5 61	2 36	3 25	17 04	17 04		17 04
TOTAL D			154 34	87 19	67 15	41 55 4 06 100 59	61 82 7 31 167 74	18 90 2 51 84 75	42 92 4 80 82 99

(Contd.)

STATEMENT II B

1	2	3	4	5	6	7	8	9
<i>C PL 480 Assistance*</i>								
1 August 1956				146 86	146 86	146 86	146 86	13 90
2 June 1958				27 13	27 13	27 13	13 23	96 68
3 September 1958				96 68	96 68	96 68	160 09	110 58
TOTAL C				270 67	270 67	270 67		
GRAND TOTAL (A+B+D+C)	27 00	377 69	211 33	193 36	1 018 29	1 211 65	478 53	733 12
* The sale proceeds of PL 480 assistance are to be used as follows								
		August 1956 authorization		June 1958 authorization		September 1958 authorization		
1 By US Government in Ind a	35 38			3 66		13 64		
2 Loan to India for economic development	111 48			16 71		54 64		
3 Mutually agreeable loans to US and Indian firms				6 76		28 40		
TOTAL	146 86			27 13		96 68		

Source Government of India, *Economic Survey 1958-59*

STATEMENT III A
PRINCIPAL EXPORTS FROM INDIA—1950-51 to 1955-56
(in lakhs of rupees)

Items	Unit	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
A Consumer goods							
1 Cashew kernels	(Thousand cwt)	855 508	905 426	1,298 558	1,099 533	1,070 680	1,292 670
2 Black pepper	(Thousand cwt)	2 040 308	2,322 298	1,606 248	1,287 255	699 276	471 263
3 Tea	(Million lb)	7,987 439	9,398 429	8,088 427	10,219 471	14,774 459	10,914 404
4 Cotton piece goods	(Million yd)	11,800 1,283	5,215 427	6,207 621	6,365 771	6,331 821	5,663 740
5 Woolen carpets and rugs		556	588	280	369	387	397
B Producers' goods							
1 Coal	(Thousand tons)	344 994	955 2,801	983 2,667	684 1,907	572 1,930	425 1,438
2 Mica	(Thousand cwt)	1,000 407	1,321 408	901 284	800 255	672 373	837 519
3 Manganese ore	(Thousand tons)	801 821	1,569 1,125	2,178 1,440	2,423 1,568	1,292 990	1,072 921

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Items	Unit	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
4. Gums, resins, and lac	(Thousand cwt)	1,361 781	1,627 821	811 763	743 654	1,151 656	1,299 713
5. Hides and skins	(Thousand tons)	3,491 41	3,354 41	2,580 37	3,106 38	2,777 36	2,911 35
6. Vegetable oils	(Million gal)	2,526 30	2,361 21	2,655 34	489 8	2,002 40	3,433 68
7. Raw cotton	(Thousand tons)	494 15	1,368 23	1,933 71	940 35	1,019 30	2,969 121
8. Raw wool	(Million lb)	787 25	490 18	841 38	587 21	861 31	973 34
9. Gunny bags	(Thousand tons)	5,539 345	13,529 473	6,139 371	4,024 353	5,685 451	5,419 452
10. Gunny cloth	(Thousand tons)	5,291 266	12,458 287	6,307 304	6,943 389	6,254 360	6,908 363
TOTAL		59,679	72,907	57,234	52,581	58,847	59,085

STATEMENT III B
 PRINCIPAL IMPORTS INTO INDIA DURING 1950-51 to 1955-56
 (in lakhs of rupees)

Items	Unit	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
<i>Consumers' goods</i>							
1 Grain, pulse and flour	(Thousand tons)	8,076	22,812	16,123	7,248	6,837	1,768 ^a
2 Fruits and vegetables excluding cashewnuts	(Value)	2,096	4,793	3,990	1,436	1,227	432
3 Spices	(Thousand cwt)	787	1,062	908	956	1,000	984
4 Textiles manufactures excluding yarn	(Value)	788	966	425	568	429	634
5 Drugs and medicines	(Value)	1,311	1,249	825	827	717	595
<i>Producers' goods</i>							
1 Raw materials		335	848	564	479	437	684
1 Hides and skins raw and tanned	(Thousand cwt)	998	1,561	1,147	1,247	1,328	1,501
2 Oils (excluding kerosene)	(Million gal)	247	123	80	112	129	198
3 Raw cotton	(Thousand tons)	146	100	83	94	127	201
4 Raw jute	(Thousand tons)	4,148	6,028	6,006	6,488	6,142	4,369
		575	682	641	693	639	549
		10,077	13,718	7,667	5,275	5,845	5,733
		215	213	138	116	123	~118
		2,757	6,708	1,648	1,432	1,300	1,933
		334	425	237	246	218	269

^a Excludes value of certain consignments of food grain awaiting adjustment

(Contd.)

STATEMENT III B

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Items	Unit	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
5 Raw wool	(Million lb)	562	259	71	178	100	142
		12	4	3	5	3	5
6 Art silk yarn	(Million lb)	1,471	1,729	785	1,204	1,269	1,544
		35	37	22	38	41	51
7 Chemicals including chemical preparations	(Value)	922	1,990	1,274	1,272	1,793	2,126
8 Dyes	(Million lb)	1,278	1,607	858	1,663	1,737	1,497
		14	15	7	16	15	13
II Capital goods							
1 Machinery, excluding consumption items	(Value)	8,752	10,516	8,530	8,351	8,282	11,451
2 Electrical goods	(Value)	945	1,019	1,485	1,310	1,118	1,502
3 Metals—Iron and Steel	(Thousand tons)	1,431	2,079	2,056	2,267	2,861	5,414
		188	165	156	220	380	715
4 Other metals	(Thousand tons)	3,274	2,276	2,271	1,614	2,844	3,829
		271	89	105	87	152	297
TOTAL		62,336	94,313	66,988	57,193	65,626	67,883

Source Reserve Bank of India, *Currency and Finance Report, 1955-56*,

INDIA'S BALANCE OF PAYMENTS

(in crore of rupees)

Department	1950			1951			Assets
	Assets	Liabilities	Net assets	Assets	Liabilities	Net assets	
I Private (excluding banks)							
1 Long term capital	-10.2	-19.1	+8.9	-12.6	-15.3	+2.7	-9.9
2 Short term capital		+0.1	-0.1		+0.9	-0.9	
II Official and banking institutions							
1 Long term capital							
(a) Official loan		+9.5	-9.5		+63.4	-63.4	
(b) Bank loans							
(c) Portfolio securities	-1.3	+4.0	-5.3	-0.1	-1.7	+1.6	-0.2
(d) Amortization	-7.4	-2.8	-4.6	-7.6	-2.3	-5.3	-7.4
(e) Other contractual repayment							
(f) Others	+14.4		+14.4		-2.9	+2.9	
2 Short term capital							
(a) Payments and clearing agreements							
(b) Liabilities to IMF and IBRD							
(c) Other liabilities to official and banking institutions		-14.2	+14.2		+23.7	-23.7	
(d) Others	+2.6	-14.1	+16.7	-51.2	-20.1	-31.2	-65.3
TOTAL	-1.9	-36.4	+34.6	-71.4	+45.7	-17.3	-82.8

MENT IV

PAYMENTS (CAPITAL ACCOUNT)

of rupees)

1952		1953			1954			1955-56		
Liabi lities	Net assets	Assets	Liabi lities	Net assets	Assets	Liab lities	Net assets	Assets	Liabi lities	Net assets
-16.6	+6.7	-10.2	-12.2	+2.0	-6.8	-9.4	+2.6	-5.4	-14.9	+9.6
+2.1	-2.0	-0.1	-7.8	+7.7	+0.1	-5.3	+5.4	-0.3	-3.8	+3.5
+55.3	-55.3		+1.7	-1.7		+0.9	-0.9		+2.5	-2.5
-2.3	+2.1		+0.8	-0.8	+0.2	+2.3	-2.1	-0.3		-0.3
-12.8	+5.3	-9.0	-12.0	+3.0	-16.1	-10.9	-5.2	-9.4	-3.3	-6.1
						-0.6	+0.6			
-3.2	+3.2									
						-22.2	+22.2		-7.1	+7.1
-37.4	+37.4		-4.4	+4.4		+15.4	-15.4		+12.1	-12.1
-30.4	-34.8	+28.2	-16.3	+44.5	+1.1	-3.6	+4.7	+24.5		+24.5
-45.4	-37.4	+9.0	-50.2	+59.2	-21.5	-33.4	+11.9	-9.1	-14.4	+23.5

STATEMENT V
INDIA'S BALANCE OF PAYMENTS (CURRENT ACCOUNT)
REGION WISE SUMMARY
(in crores of rupees)

Head	1951	1952	1952-53	1953-54	1954-55	1955-56
<i>All areas</i>						
Imports c i f	862.4	742.6	631.0	591.8	688.8	761.4
Exports f o b	749.5	649.1	601.9	539.7	596.6	640.2
Trade balance	-112.9	-93.5	-31.1	-52.2	-87.2	+21.2
Official donations	+1.4	+11.9	+10.8	+19.0	+15.8	+45.0
Other invisibles (net)	+44.1	+83.3	+80.5	+80.5	+77.4	+88.5
Current account (net)	-57.4	+1.7	+60.2	+47.4	+6.0	+12.3
<i>Sterling area</i>						
Imports c i f	380.5	297.5	281.8	302.3	357.4	361.2
Exports f o b	394.5	343.4	306.2	291.2	339.7	330.9
Trade balance	+14.0	+45.9	+24.4	-11.1	-17.7	-30.3
Official donations	+1.4	+2.8	+1.5	+0.4	+0.1	+0.1
Other invisibles (net)	+66.7	+75.1	+73.0	+74.9	+69.8	+74.4
Current account (net)	+82.1	+123.8	+98.9	+64.2	+52.9	+44.2
<i>Dollar area</i>						
Imports c i f	247.5	279.6	185.6	108.4	116.8	132.2
Exports f o b	183.2	154.7	143.8	115.6	113.3	120.4
Trade balance	-64.3	-124.9	-41.8	+7.2	-3.5	-11.8

(Contd.)

STATEMENT V

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Head	1951	1952	1952-53	1953-54	1954-55	1955-56
Official donations		+76	+93	+186	+150	+449
Other invisibles (net)	+25	+61	+56	+14	+34	+61
Current account (net)	-618	-1112	-269	+272	+149	+392
<i>OEEC countries</i>						
Imports c i f	1089	867	822	1016	1350	1543
Exports f o b	850	656	631	454	606	725
Trade balance	-239	-211	-191	-562	-744	-818
Official donations		+11				
Other invisibles (net)	-19	-10	-12	-13	-13	-27
Current account (net)	-258	-210	-203	-575	-757	-845
<i>Rest of non-sterling area</i>						
Imports c i f	1253	788	834	795	746	1137
Exports f o b	868	854	888	875	830	1164
Trade balance	-385	+66	+54	+80	+84	+27
Official donations		+04				
Other invisibles (net)	-133	+30	+31	+55	+55	+107
Current account (net)	-518	-100	+85	+135	+139	+134

STATEMENT VI A
EXPORT OF GUNNY CLOTH AND BAGS TO PRINCIPAL COUNTRIES
 (in lakhs of rupees)

<i>Area/Country</i>	<i>1950-51</i>	<i>1951-52</i>	<i>1952-53</i>	<i>1953-54</i>	<i>1954-55</i>	<i>1955-56</i>
<i>Gunny cloth</i>						
1 Sterling area countries						
(a) UK	441	3,107	455	1,063	1,002	515
(b) Australia	181	514	140	223	222	257
(c) New Zealand			43	34	61	61
2. Other soft currency countries						
(a) Egypt	70	149	42	31	70	65
(b) Uruguay	32	213	132	119	145	146
(c) Argentina	901	1,666	668	1,899	1,205	1,047
3 Dollar countries						
(a) USA	3,009	5,267	3,669	2,563	2,760	2,887
(b) Canada	375	658	441	439	481	502
(c) Philippines	39	125	101	61	14	10
<i>Gunny bags</i>						
1 Sterling area countries						
(a) UK	156	1,093	253	243	314	248
(b) Australia	1,170	2,600	948	597	1,105	1,119
(c) Burma	221	8,880	266	197	293	289
(d) Nigeria	107	389	278	153	256	206
(e) Kenya Colony, Zanzibar and Pemba	153	343				
2 Other soft currency countries						
(a) Egypt	279	236	176	23	301	329
(b) Chile	116	251				
(c) China	320	529				
(d) Peru			175	128	97	135
(e) Thailand			249	219	138	196
3 Dollar countries						
(a) USA	16	15	14	8	10	12
(b) Cuba	703	1,125	747	405	456	423

SOURCE The Reserve Bank of India, *Currency and Finance Reports*

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STATEMENT VI B

EXPORTS OF COTTON PIECEGOODS AND TEA TO PRINCIPAL COUNTRIES

(in lakhs of rupees)

Area Country	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
<i>Cotton piecegoods</i>						
1 Sterling area countries						
(a) UK		509	23	311	835	604
(b) Malaya	3,063	676	923	402	319	249
(c) Aden and Dependencies	617	295	573	528	320	245
(d) Ceylon	919	110	198	183	192	189
(e) Nigeria	342	80	125	329	321	353
(f) Tanganyika	151	96	238	176	224	186
(g) Kenya Colony, Zanzibar and Pemba	293	169	300	273	269	240
(h) Australia	576	386	79	439	391	394
(i) Burma	1,247	153	742	599	229	88
2 Other soft currency countries						
(a) A E Sudan	264	160	389	251	414	314
(b) Arabia	292				175	89
(c) Afghanistan	..	263	291	207		
<i>Tea</i>						
1 Sterling area countries						
(a) UK	4,665	6,091	5,523	7,288	1,0222	7,395
(b) Irish Republic	533	602	217	475	734	561
(c) Australia	321	133	196	78	277	151
(d) Kuwait			141	73	97	73
2 Other soft currency areas						
(a) USSR		112				
(b) Iran	318	372				
(c) Arabia	152					
(d) Netherlands		122	124	132	138	104
(e) A E Sudan			77	100	129	69
(f) Chile			55	25	52	
(g) Egypt				216	351	412
3 Dollar countries						
(a) USA	795	629	595	721	1 041	678
(b) Canada	429	431	425	473	739	472

STATEMENT VII A

RETURN ON FOREIGN INVESTMENTS OF
UK AND US COMPANIES (COMBINED) IN 1953 AND 1955

(in lakhs of rupees)

Head	1953			1955		
	Net foreign liability or net worth	Profit after tax	Percentage of return	Net foreign liability or net worth	Profit after tax	Percentage of return
Manufacturing	4,998	504	10.1	10,797	1,169	10.8
Trading	8,262	604	7.3	9,242	604	6.5
Plantations	6,324	1,218	19.3	8,000	946	11.8
Others	2,273	312	13.7	2,808	327	11.6
All activities	21,857	2,638	12.1	30,847	3,046	9.9

STATEMENT VII B

RETURN ON INVESTMENTS OF UK AND US
COMPANIES (BREAK-UP) IN 1953 AND 1955

(in lakhs of rupees)

Head	1953			1955		
	Net foreign liability or net worth	Profit after tax	Percentage of return	Net foreign liability or net worth	Profit after tax	Percentage of return
<i>UK Companies</i>						
Manufacturing	4,521	409	9.0	9,445	899	9.5
Trading	6,390	382	6.0	6,938	404	5.9
Plantations	6,324	1,218	19.3	8,000	946	11.8
Others	2,271	312	13.7	2,808	326	11.6
All activities	19,506	2,321	11.9	27,191	2,577	9.5
<i>US Companies</i>						
Manufacturing	477	95	19.9	1,352	270	20.0
Others	1,874	222	11.8	2,304	199	8.6
All activities	2,351	317	13.5	3,656	469	12.8

STATEMENT VIII
INDEX NUMBERS OF AGRICULTURAL PRODUCTION (Base=1950)

Commodities/group	Weight	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58
Rice	153	90.1	96.8	118.6	105.5	112.7	119.1	104.5
Wheat	85	93.9	112.7	120.0	133.7	130.5	141.6	116.4
Jowar	50	96.4	106.6	117.0	133.4	98.5	105.9	117.7
Bajra	27	75.8	94.8	135.0	106.3	108.3	92.0	113.6
Maize	21	101.3	123.3	130.2	127.9	111.1	132.0	134.4
Total cereals	58.3	91.2	101.4	120.1	114.0	113.7	119.9	108.3
Gram	37	88.2	109.2	125.4	142.2	140.6	163.3	123.9
Total pulses	8.6	90.3	98.8	112.0	117.3	112.3	124.5	100.9
Total food grains	66.9	91.1	101.1	119.1	114.4	113.5	120.5	107.3
Groundnut	57	93.0	85.3	100.3	112.8	114.2	124.2	126.3
Total oil seeds	9.9	97.4	91.9	103.7	121.7	107.2	118.9	112.3
Cotton	2.8	119.2	121.0	151.8	163.1	151.6	182.2	182.9
Jute	1.4	151.4	148.6	100.0	94.7	135.7	138.7	132.3
Mesta	0.3	104.8	103.3	98.5	154.3	175.7	223.9	183.5
Total fabrics	4.5	128.3	128.4	132.1	141.2	148.3	171.4	167.2
Tea	3.3	109.6	115.4	100.6	110.7	113.3	114.1	115.0
Coffee	0.2	112.7	125.9	146.5	148.0	197.1	216.3	212.1
Rubber	0.1	94.4	106.1	131.8	127.6	133.5	143.9	145.9
Total plantations	3.6	109.4	115.7	104.0	113.2	118.5	120.6	121.8
Sugarcane	8.7	122.8	101.6	89.5	116.7	121.2	135.3	127.6
Tobacco	1.9	78.0	91.3	101.5	93.9	98.1	115.9	108.7
Total miscellaneous	15.1	114.0	101.5	97.4	115.0	120.6	108.0	121.1
Total non food grains	33.1	110.5	103.8	104.7	120.4	120.7	130.4	125.7
All commodities	100.0	97.5	102.0	114.3	116.4	115.9	123.8	113.4

SOURCE: *Agricultural Situation in India August 1957* Currency and Finance Report 1957-58

STATEMENT IX
INDUSTRIAL PRODUCTION
 (Base 1951=100)

<i>Industry</i>	<i>Weight</i>	<i>1954</i>	<i>1955</i>	<i>1956</i>	<i>1957</i>
1 Textile manufactures	48	110.0	113.6	119.9	116.8
Cotton cloth	24	109.5	109.2	115.2	189.7
Cotton yarn	12	113.5	117.3	122.0	127.5
Jute textiles	12	107.3	118.9	127.3	120.5
2 Sugar	4	97.4	143.0	166.5	185.4
3 Paper and paper boards	2	117.7	140.2	146.6	159.8
4 Cigarettes	2	92.4	106.4	122.6	134.7
5 Coal	7	107.2	111.4	114.9	126.9
6 Iron and steel	6	113.2	113.3	119.4	119.3
Finished steel	4	115.5	117.1	124.2	125.1
Pig iron and ferro alloys	2	107.5	103.9	107.3	104.8
7 General engineering	5	151.9	183.3	218.1	241.3
Hurricane lanterns	2	125.4	138.0	130.3	109.3
Diesel engines	0.2	119.4	141.0	165.8	229.7
8 Chemicals & chemical products	4	141.1	159.0	171.1	181.3
Soap	1	105.5	118.7	132.1	133.8
Matches	1	91.5	106.6	106.6	100.1
Sulphuric acid	0.2	141.1	155.4	154.5	183.3
9 Automobile	3	64.9	103.7	144.3	143.4
10 Rubber products	3	127.7	140.2	151.6	165.5
Tyres	2	126.3	138.2	151.4	170.1
11 Electricity generated	2	127.0	131.2	164.1	184.9
12 Cement	2	137.6	140.4	144.2	175.3
13 Non ferrous metals	1	126.5	123.7	124.7	151.7
Brass	1	139.2	116.1	120.9	158.2
14 Iron ore	0.5	107.8	116.7	116.1	126.8
15 General Index	100	112.9	122.1	132.6	137.2

SOURCE: Govt. of India, Ministry of Commerce & Industry, *Monthly Statistics of the Production of Selected Industries of India*

STATEMENT X

DISTRIBUTION OF PLAN OUTLAY BY MAJOR HEADS
OF DEVELOPMENT

Head	First Five Year Plan total provision		Second Five Year Plan total provision		Percent- age increase of 4 over 2
	Rs crores	Per- centage	Rs crores	Per- centage	
1	2	3	4	5	6
I. Agriculture and Community Development	357	15.1	568	11.8	59.1
(a) Agriculture	241	10.2	341	7.1	
Agricultural programmes	197	8.3	170	3.5	
Animal husbandry	22	1.0	56	1.1	
Forests	10	0.4	47	1.0	
Fisheries	4	0.2	12	0.3	
Cooperation	7	0.3	47	1.0	
Miscellaneous	1		9	0.2	
(b) National extension and community projects	90	3.8	200	4.1	
(c) Other programmes	26	1.1	27	0.6	
Village panchayats	11	0.5	12	0.3	
Local development works	15	0.6	15	0.3	
II. Irrigation and Power	661	28.1	913	19.0	38.1
Irrigation	364	16.3	381	7.9	
Power	260	11.1	427	8.9	
Flood control and other projects	17	0.7	105	2.2	
III. Industry and Mining	179	7.6	690	18.5	197.2
Large and medium industries	148	6.2	617	12.9	
Mineral development	1		73	1.5	
Village and small industries	30	1.3	200	4.1	

(Contd.)

STATEMENT X (Contd)

DISTRIBUTION OF PLAN OUTLAY BY MAJOR HEADS OF DEVELOPMENT

Head	First Five Year Plan total provision		Second Five Year Plan total provision		Percent age increase of 4 over 2
	Rs crores	Per centage	Rs crores	Per centage	
	1	2	3	4	
IV <i>Transport and Communications</i>	557	23.6	1 385	28.9	148.7
Railways	268	11.4	900	18.8	
Roads	130	5.5	246	5.1	
Road transport	12	0.5	17	0.4	
Ports and harbours	34	1.4	45	0.9	
Shipping	26	1.1	48	1.0	
Inland water transport			3	0.1	
Civil air transport	24	1.0	43	0.9	
Other transport	3	0.1	7	0.1	
Posts and telegraph	50	2.2	63	1.3	
Other communications	5	0.2	4	0.1	
Broadcasting	5	0.2	9	0.2	
V <i>Social Services</i>	533	22.6	945	19.7	77.3
Education	169	7.0	307	6.4	
Health	140	5.9	274	5.7	
Housing	49	2.1	120	2.5	
Welfare of backward classes	32	1.3	91	1.9	
Social welfare	5	0.2	29	0.6	
Labour and labour welfare	7	0.3	29	0.6	
Rehabilitation	136	5.8	90	1.9	
Schemes related to educated unemployment			5	0.1	
VI <i>Miscellaneous</i>	69	3.0	99	2.1	43.5
TOTAL	2 356	100.0	4 800	100.0	

MAIN TARGETS OF PRODUCTION AND DEVELOPMENT

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Section and item	Unit	1950-51	1955-56	1960-61	Percentage increase in 1960-61 over 1955-56
I Agriculture					
1 Foodgrains	Million tons	54.0	65.0	75.0	15
2 Cotton	Million bales	2.9	4.2	5.5	31
3 Sugarcane—raw gur	Million tons	5.6	5.8	7.1	22
4 Oilseeds	Million tons	5.1	5.5	7.0	27
5 Jute	Million bales	3.3	4.0	5.0	25
6 Tea	Million pounds	613	644	700	9
7 National extension blocks	Number		500	3,800	660
8 Community development blocks	Number		622	1,120	80
II Irrigation and Power					
1 Area irrigated	Million acres	51	67	88	31
2 Electricity (installed capacity in million kw.)		23	34	69	103
III Minerals					
1 Iron ore	Million tons	3.0	4.3	12.5	191
2 Coal	Million tons	32.3	18.0	60.0	58
IV Large scale industries					
1 Finished steel	Million tons	1.1	1.3	4.3	231
2 Aluminium	Thousand tons	3.7	7.5	24.0	233
3 Automobiles	Number	16,000	25,000	57,000	128

(Contd.)

STATEMENT XI (Contd.)
MAIN TARGETS OF PRODUCTION AND DEVELOPMENT

	Sector and item	Unit	1950-51	1955-56	1960-61	Percentage increase in 1960-61 over 1955-56
4	Railway locomotives	Number	3	175	400	129
5	Cement	Million tons	27	43	13	202
6	Fertilizers					
	(a) Nitrogenous in terms of Am sulphates	Thousand tons	46	380	1,450	282
	(b) Phosphatic in terms of Super phosphate	Thousand tons	55	120	720	500
7	Cotton textile	Thousand yards	4,618	6,850	8,500	24
8	Sugar	Million tons	11	17	23	35
9	Paper and paper boards	Thousand tons	114	200	350	75
V Transport and Communications						
1	Railways					
	(a) Passenger train	Million miles	95	108	124	15
	(b) Freight carried	Million tons	91	120	162	35
2	Roads					
	(a) National highways	Thousand miles	123	129	138	7
	(b) Surfaced roads	Thousand miles	970	1070	1250	17
3	Post offices	Thousands	36	55	75	36
VI Education and Health						
1	Elementary/basic schools	Lakhs	223	293	350	19
2	Teachers in primary/middle/secondary schools	Lakhs	74	103	134	30
3	Medical institutions	Thousands	86	10	126	26

STATEMENTS

STATEMENT VII

INDIA'S OVERALL BALANCE OF PAYMENTS

(in crores of rupees)

<i>Head</i>	<i>1956 57 (Revised)</i>	<i>1957 58 (Revised)</i>	<i>1958 59 (Preliminary)</i>
1 Imports c i f			
(a) Private	804.3	695.1	518.6
(b) Government	291.3	409.1	527.9
TOTAL	1 095.6	1 204.2	1 046.5
2 Exports f o b	635.1	594.7	576.1
3 Trade balance	-460.5	-609.5	-470.4
4 Official donations	+44.7	+32.7	+40.9
5 Other invisibles (net)	+109.0	+100.9	+90.7
6 Current account (net)	-306.8	-475.9	-338.8
7 Errors and omissions	-10.7	-4.1	-28.0
8 Official loans	+60.1	+92.3	+216.7
9 Other capital transactions	+36.1	+127.8	+103.5
10 Movement in reserves	-221.3	-259.9	-46.6

STATEMENT XIII

INDIA'S BALANCE OF PAYMENTS
CURRENT ACCOUNT REGION WISE SUMMARY

<i>Area</i>	<i>1956-57</i>	<i>1957-58</i>	<i>1958-59</i> <i>(Preliminary)</i>
<i>All areas</i>			
1 Imports c i f	1 099.5	1 204.2	1 046.5
2 Exports f o b	635.2	669.1	576.1
3 Trade balance	-464.3	-535.1	-470.4
4 Official donations	+39.5	+32.7	+40.9
5 Other invisibles (net)	+112.5	+100.9	+90.7
6 Current account (net)	-312.3	-401.5	-338.8
<i>Sterling area</i>			
1 Imports c i f	466.5	449.6	392.8
2 Exports f o b	332.6	298.2	300.4
3 Trade balance	-133.9	-151.4	-92.4
4 Official donations	+2.1	+4.6	+2.3
5 Other invisibles (net)	+93.9	+72.8	+53.7
6 Current account (net)	-37.9	-74.0	-36.4
<i>Dollar area</i>			
1 Imports c i f	209.5	269.8	246.7
2 Exports f o b	121.0	192.6	104.5
3 Trade balance	-88.5	-77.2	-142.2
4 Official donations	+37.2	+28.0	+38.5
5 Other invisibles (net)	+6.8	+14.4	+27.8
6 Current account (net)	-44.5	-34.8	-75.9
<i>OEEC countries</i>			
1 Imports c i f	262.3	299.8	216.2
2 Exports f o b	62.6	57.6	50.8
3 Trade balance	-199.7	-242.2	-165.4
4 Official donations	+0.1	+0.1	+0.1
5 Other invisibles (net)	-0.3	+1.0	-3.2
6 Current account (net)	-199.9	-241.1	-168.5
<i>Rest of non sterling area</i>			
1 Imports c i f	161.2	185.0	190.8
2 Exports f o b	119.0	120.7	120.4
3 Trade balance	-42.2	-64.3	-70.4
4 Official donations	+0.1		
5 Other invisibles (net)	+12.1	+12.7	+12.4
6 Current account (net)	-30.0	-51.6	-58.0

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